WILLKIE FARR & GALLAGHER LLP **MEMORANDUM**

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher

RE: Interview of Tom Story on April 28, 2006

DATED: July 7, 2006

On April 28, 2006, Michael Schachter, Carolyn Miller, and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Tom Story at the City Administration Building, 202 C Street, in San Diego, in a conference room on the third floor. Johnny Giang and Tammie Davis from KPMG also attended the interview. Mr. Story was represented by Theresa McAteer, Esq. from McAteer & McAteer, at the interview.

The following memorandum reflects my thoughts, impressions and opinions regarding our meeting with Mr. Story and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Schachter informed Mr. Story that we are counsel to the Audit Committee and do not represent him or any employee. He advised Mr. Story that the interview may be considered attorney work product and confidential, but the decision of whether to keep it confidential will be made by the Audit Committee in the best interests of the City, not by Mr. Story personally. Mr. Schachter said we will create a report which may contain statements of interviewees, and this report will likely be provided to KPMG and ultimately made public. He said government agencies may view the report and be provided with additional information so it is important to be truthful and accurate.

Background

Mr. Schachter asked Mr. Story to describe his professional background. Mr. Story said that he received a B.A. from Utah State University in 1977 in Landscape Architecture. He then worked for several landscape architecture firms until being hired by PRC Engineering in San Diego, where he worked for three years as the principal architect for the City. In 1989, he was promoted to Deputy Director, a position in which he served until 1993. In 1993, Mr. Story became involved with the Multiple Species Conservation Program and, in 1997, became the administrator of the Program as Deputy Planning Director of the Planning Department. He served in that position until December 2000. As Deputy Planning Director, he supervised staff working on transportation planning and coordinating the Multiple Species Program. The Planning Director asked him if he wanted to apply to work for the Mayor. He said he had been somewhat active in the Murphy campaign, from having a yard sign on his lawn to making a modest political contribution, but had not spoken with Mayor Murphy before going to work for

him. In December 2000, he became Senior Policy Advisor to Mayor Dick Murphy and served in this position until April 2004, when John Kern, the Mayor's Chief of Staff, retired. Mr. Story said that from April 2004 until July 31, 2005, he served as the Mayor's Chief of Staff. (In fact, John Kern retired as the Mayor's Chief of Staff in April 2005, not April 2004; Mr. Story did not become Chief of Staff until early 2005.)

Job Responsibilities

Mr. Schachter asked Mr. Story to discuss his job responsibilities as Senior Policy Advisor. Mr. Story responded that his duties as Senior Policy Advisor did not change over time. His job was to be knowledgeable about his issue areas and to make recommendations to the Mayor. He was responsible for land use, environmental issues, transportation, wastewater, energy, and regional governance. He did not deal with budgets or special projects, fire, or public safety.

Mayor Murphy

Mr. Schachter asked Mr. Story to describe Mayor Murphy's reputation. Mr. Story responded that Dick Murphy's reputation was that of an ethical, standup guy. Mr. Story recalled being in a car in a parking garage with Mayor Murphy and Mayor Murphy yelling at Mr. Story because he did not have a seat belt on. Mayor Murphy was a "stickler for following the rules." He referred to Mayor Murphy as in the mold of former California Governor and former San Diego Mayor Pete Wilson. He explained that Mayor Murphy ran as an outsider, not a politician. Mayor Murphy promised to tackle the major problems of the day: a stalled ticket guarantee for the Chargers and a rash of sewer spills that were occurring on a daily basis. Mayor Murphy campaigned as a problem solver and as someone who was not beholden to special interests. Mr. Story said that Mayor Golding had fired staff for supporting or opposing recommendations that conflicted with her political supporters. While working for Mayor Murphy, he never had one day where he was uncomfortable with what Mayor Murphy asked him to do.

The Mayor's Office

Mr. Schachter asked Mr. Story to describe the structure of the Mayor's Office. He said that the Mayor can structure his office any way he would like to, within budgetary constraints. Twenty-five people worked in Mayor Murphy's Office, including the Mayor, the Chief of Staff, the Press Secretary, Assistant Press Secretary, two senior policy advisors, a Community Relations Department consisting of seven people, two schedulers, the Mayor's personal secretary, a receptionist, two administrative staff, a veterans/military liaison, and Rules Committee Consultant Bill Baber, who managed the City Council docket. John Kern was the Chief of Staff and Dennis Gibson was the other policy advisor, who handled public safety, ballparks, budgets, libraries, and labor negotiations.

Mr. Schachter asked Mr. Story what was the last name of "Steve" who worked in the Mayor's Office. Mr. Story responded that Steve Heyendehl was an intern in the Mayor's Community Relations Department who worked with Mr. Story on policy issues after January 2005. Mr. Schachter asked Mr. Story if he knew who Dennis Kahlie was. He said that Dennis Kahlie was an analyst in Financial Management and that he interacted with him a handful of times regarding water and wastewater.

Story's Relationships at the Mayor's Office

Mr. Schachter asked Mr. Story to describe his relationship with the senior personnel in the Mayor's Office. Mr. Story responded that he was friends with the Mayor but did not start off as friends but rather saw their friendship develop. He said that Kern had a unique style of communication and was brusque. Kern was a "great guy" and Mr. Story had a good friendship with him. Kern was the perfect supervisor for him because he told Mr. Story what needed to get done but did not tell Mr. Story how to go about actually getting it done. Kern was a terrible manager who yelled at people when they did not do what he wanted them to do. Kern did not have the tools to effectively direct others and was known for holding five-minute meetings. Gibson was not a good fit in the Office because he had a need for more management. Mr. Story had virtually no contact with Gibson. Mr. Story said that Gibson was skilled at getting others to do his work for him.

Relationship between the Mayor and City Manager

Mr. Schachter asked Mr. Story to describe the relationship between the Mayor and the City Manager. Mr. Story responded that the relationship between the two varied based on the personalities involved. The City Manager wanted everything to go smoothly but was not skilled at the politics of a large city. The Mayor provided direction and the City Manager was accommodating. The City Manager under Mayor Murphy first was Michael Uberagua and then was Lamont Ewell. Uberagua liked to delegate a lot and dealt with some things but did so less directly than his predecessors. Uberagua rarely met with Mr. Story or the Mayor about Mr. Story's issue areas, while the City Manager often met with the Mayor regarding budget issues. For his issues, Mr. Story dealt directly with either the Deputy City Manager or the department heads. For wastewater, he dealt with Scott Tulloch (Director of MWWD), whom he believed was competent and did not need a lot of support from the Deputy City Manager. Mr. Story worked with Deputy City Manager George Loveland on engineering, water, and wastewater issues. He found the Deputy City Managers to be competent and capable. Richard Mendes (Deputy City Manager) replaced Loveland after Loveland retired. Working with the department heads and the Deputy City Managers was a collaborative positive process. He did not recall regular meetings between the Mayor and Uberagua.

Relationship between the Mayor and City Council

Mr. Schachter asked Mr. Story to describe the relationship between the Mayor and the City Council. Mr. Story responded that the major communications between the Mayor and the Council took place regarding Mayor Murphy's ten goals. Mayor Murphy's goals included energy independence; open space/multiple species conservation; restructuring regional governance; improving the airport authority; cleaning up beaches and bays; reducing traffic congestion; building a public library; and public safety. Mayor Murphy established a partnership with each Council member for at least one of the goals. For example, for the Clean Water Task Force, Mayor Murphy worked with Councilmembers Frye and Peters, while Mayor Murphy worked with Councilmember Maienschein on freeway construction and Councilmember Zucchet on energy independence. The Mayor and Council member would interact very directly on that policy issue and would co-chair task force meetings either monthly or quarterly. Mr. Story had regular contact with Council staff on his issue areas. His work with Council staff was collaborative and extremely positive. Mr. Story would meet with Council staff for an agenda-

setting meeting prior to the task force meeting, during which he would draft the agenda with the Council staff member.

Closed Sessions in General

Mr. Schachter asked Mr. Story to describe the mechanics of Closed Session Council meetings. Mr. Story responded that Bill Baber was the Rules Committee Consultant and put together the briefing packets for the Mayor. Mr. Story only attended two Closed Sessions when he worked for the Mayor and did not see the Closed Session briefing materials. During Mayor Golding's administration, ten to fifteen staff members attended the Closed Sessions and they were "packed" with people. Mayor Murphy changed the composition of Closed Session, only allowing the Council members, the City Manager, the attorneys, and the Council staff responsible for a particular issue to attend. Mr. Story was not allowed to attend and had to wait for City staff to tell him what happened at the Closed Sessions.

Wastewater

Closed Sessions about Wastewater Issues

Mr. Schachter asked Mr. Story if he was aware of a January 29, 2002 Closed Session meeting where Kahlie and Kelly Salt (Chief Deputy City Attorney of the Public Works Section) made a presentation to the Council about the City's lack of compliance with State requirements and discussed the possible consequences of that noncompliance. Mr. Story said that he did not attend the meeting and is not sure when he became aware of the issue. He knew Kahlie was responsible for "bringing the report forward."

Mr. Schachter asked Mr. Story if he recalled the issue of the Cost of Service Study ("COS") and the noncompliance being addressed in Closed Session. Mr. Story did recall that the rate structure issue came up in Closed Session but did not recall when. He did not recall whether there was a negative response to changing the rate structure by the Council. He believed he learned from staff, perhaps Loveland, about the Closed Session, but did not know when he learned of it. He did not recall talking with Kahlie other than at the briefings.

Meetings with the Mayor about COS

Mr. Schachter asked Mr. Story if he recalled any meetings with the Mayor in which the noncompliance issues were raised. Mr. Story recalled having briefings in the Mayor's Office with Kahie and Loveland. He speculated that Tulloch and Kern would have attended these briefings as well. Kahlie did most of the talking during the briefings and Loveland introduced the issues. In these briefings, he was told that the City was vulnerable regarding the State Revolving Fund ("SRF") loans and grants because the City was not charging City users in the same manner as the City was charging the Participating Agencies ("PA's"). He was told that the State had been under the impression that there was the same rate structure for both but had recently discovered the discrepancy and expected the City to modify the rate structure for City users. He was told that staff worked on the issue before Mayor Murphy came into office.

Mr. Schachter asked Mr. Story to describe in more detail what he was told at these briefings. During the briefings, he recalled discussion concerning the consequences of not

bringing the City into compliance, including acceleration of the loans and repayment of the grants. He recalled a change in the rate structure being involved, including allocating costs for organics. Mr. Story recalled a discussion that the impact of the changes would be revenue neutral and that reallocation would shift the costs from residents to commercial users. He also recalled discussion that the particular industries affected were those with a high level of organics, which he said included the restaurants and ISP/Kelco.

Mr. Schachter asked Mr. Story to discuss Mayor Murphy's reaction to the briefings conducted by Kahlie and Loveland about the sewer rate structure and the noncompliance issues. Mr. Story responded that he did not recall a reaction other than that the Mayor felt that there was a problem. There was an effort to look at the water COS concurrently. Mayor Murphy viewed the sewer rate structure issue as just another challenge and understood that there was a mandate to change the rate structure. The only question was what was the best way to enact the change. Mr. Schachter asked Mr. Story if he recalled the Mayor being opposed to changing to rate structure and if he met with the Mayor after the COS meeting. He did not recall the Mayor saying the rate structure should or should not be changed. He did not recall speaking with the Mayor after the briefings. It was his impression that it was not a question of whether but when the rate structure change would be docketed. Mayor Murphy's "rule of thumb" was that there was to be only one controversial item on the docket on any given week. Mayor Murphy made this rule so that there would be an efficient functioning of the Council meetings and waiting time at the meetings would be minimized. A timing issue about the rate structure issue came up later because notices for water and sewer changes went out for the same day and Mayor Murphy was upset that there would be two controversial issues on the docket at the same time. At that time, the Mayor had not yet agreed to the docketing of those items.

Why the Rate Structure was Not Changed

Mr. Schachter asked Mr. Story why the rate structure was not changed earlier. Mr. Story did not recall being informed why the rate structure was not changed in a timely manner under Mayor Golding. He assumed that he learned during the COS meetings with the Mayor that the rate structure initiative began under Mayor Golding. Mr. Story learned during those meetings that the COS had to be done and that was why Mayor Golding did not enact the changes. For Golding, the outgoing Mayor, there was "no value in resolving the issue." Mr. Schachter asked Mr. Story what he meant by that comment. He explained that there was no political value in changing the rate structure because there would be a substantial increase in costs to businesses which could undermine the competitiveness of the City in attracting businesses to relocate to San Diego. San Diego did not want to be seen as anti-business.

Mr. Schachter again asked Mr. Story why the rate structure was not changed earlier. Mr. Story did not know why the rate structure was not changed earlier and said he was "not on Council" and therefore cannot answer the question. He said that the COS did not call for a change in the rate structure but rather analyzed the rate structure. He said that changes in rate structures involved winners and losers and the losers typically object. How to structure a particular rate structure involved lots of variables that can be argued about. It was his impression that under the prior administration, decisions on rate structures were made based on political rather than technical reasons. It was his impression that under Mayor Golding, policy decisions were sometimes made by "fiat" instead of careful analysis.

Mr. Schachter asked Mr. Story whether any elected official did not want to implement the COS and whether any Council member said "let them sue us" rather than implement the COS. Mr. Story did not recall hearing of any Council member opposed to it. He did not recall any Councilmember saying "let 'em sue us." He did not recall Mayor Murphy voicing a view that the City should wait until the State sued the City.

Mr. Schachter asked Mr. Story why the Mayor did not cause the rate structure to be changed prior to June 2004. Mr. Story replied that we should "ask Murphy" and that he did not participate in discussions about it with Mayor Murphy.

Kelco

Mr. Schachter asked Mr. Story whether Kelco contributed to either Mayor Golding or Mayor Murphy. He responded that he did not hear of Mayor Golding having a relationship with Kelco and he did not hear of political contributions influencing either Mayor Golding or the Council. He did not know if Kelco was a contributor to Mayor Murphy and he did not know if Kelco held a fundraiser for Mayor Murphy.

Mr. Schachter asked Mr. Story to discuss Kelco's role in the rate structure issue and the meetings Mr. Story had with Kelco. He replied that meetings with Kelco likely occurred in 2003-2004. He, Kelco, and Mayor Murphy met and discussed Kelco and its importance to the economy. Mendes also attended some of the meetings, as did Doug Sain. In these meetings, the City agreed to do what it could to try to even out the cost of Kelco complying with the new rate structure. By way of a letter, Kelco asked for a delay of the rate structure changes. In the meetings with the Mayor, Kelco's initial position was that no new rate structure should be implemented. Mr. Story did not recall Mayor Murphy supporting that position. Kelco was concerned that increased sewer charges would make them less competitive and force them to leave San Diego. Kelco asked to have Mendes try to work out a solution that would result in Kelco conducting on-site pretreatment to comply with the new rate structure and receive credit for reducing organics in their discharge but still be subject to the State requirements. If Kelco's discharge was reduced at the Kelco plant, discharge would not need to be reduced at Point Loma, which would create value to the City through pretreatment. Kelco felt this value should be reflected in how the costs were spread. Mendes felt a fair case could be made for trying to spread upfront capital costs for Kelco. Mendes told him that the City Attorney's Office would not approve this type of arrangement and the issue died. One year later, Kelco left San Diego.

Mr. Story was shown Exhibit 1, a May 14, 2004 email from Dick Murphy to John Kern re: "Fwd: COD/BOD – Please help us!", attaching an email from Kimberly Wilbur to Dick Murphy re: "COD/BOD – Please help us!" Mr. Story said that the email sounds very familiar and that campaign activity and work at the office were kept strictly separate. He had no involvement with fundraisers. He was familiar with ISP's position in seeking a delay on the implementation of the COS. Mr. Schachter asked Mr. Story if he recalled discussions regarding the propriety of Exhibit 1. He did not recall any discussion regarding the propriety of linking a fundraiser with asking for action from the Mayor. He said it is not unusual for donors to think that "you owe them something."

Mr. Story was shown Exhibit 2, a May 17, 2004 email from Tom Story to Rossana Burgess re: "Fwd: COD/BOD – Please help us!", attaching a May 14, 2004 email from

John Kern to Kimberly Wilbur, Doug Sain, and Tom Story re: "COD/BOD – Please help us!" Mr. Schachter asked Mr. Story if he recalled a discussion that the Office needed to respond to this email in writing. He replied that he did not. Mr. Schachter asked if Kelco organized fundraisers for Mayor Murphy before January 2004. He did not have knowledge of fundraisers by Kelco for Mayor Murphy before January 2004. Mr. Schachter asked Mr. Story if he was familiar with the response given. He was familiar with the response to Kelco and he said it was not uncommon for donors to expect decisions favorable to their interests. Mr. Schachter asked Mr. Story to describe Kern's position on this issue. He said that Kern's position was that while the support was appreciated, it did not mean that the Mayor was obligated to act in a particular way. Kern's position was discussed in the office and the feeling was that people can expect what they want but that the Mayor's Office would not necessarily act upon those expectations. He did not recall drafting the response to the email or participating in it. Kern copied Mr. Story on the response and would have made him aware of it after sending it. Mr. Schachter asked Mr. Story if he spoke with Kern before Kern sent out the response. Mr. Story did not recall.

The COS

Mr. Schachter asked Mr. Story whether he reviewed the 2002 COS, which said that the City would face a big liability if it did not change the rate structure. He did not recall the May 2002 COS, but said that it "could have crossed his desk." He did not recall reviewing a COS that described requirements to change the rate structure. Mr. Story did not recall the City doing multiple COS before May 2002 that described requirements for changing the sewer rate structure. Mr. Schachter asked Mr. Story if he thought the State's threat was real. He said it was his impression that State agencies are willing to work to ensure compliance and are compliance-oriented rather than penalty-oriented. The threat to the City that the City would have to repay the grants was real but was not likely to be implemented unilaterally. The State agencies wanted compliance and if compliance was accomplished over time, that was acceptable to them. When asked by Mr. Schachter, he said he did not recall these thoughts being discussed during the COS meetings with the Mayor but felt that it was likely that these thoughts would have been discussed during those meetings.

Mr. Story was shown Exhibit 3, a COS distributed in November 2002 and handstamped "Draft." Mr. Story said this COS would have come across his desk in the normal course of business. Mr. Schachter asked Mr. Story if this COS was final. He replied that he did not hear it was final but thought it was distributed as a draft study. Mr. Schachter asked who had stamped it "draft." He did not know who hand-stamped it "draft." Mr. Schachter asked Mr. Story if the City Manager directed that the COS be released in draft form. Mr. Story did not recall. He did not know why the COS was distributed in November 2002. He knew Councilmember Frye raised questions about the COS but he did not know if that was the catalyst for its distribution this time.

Mr. Story was shown Exhibit 4, an October 6, 1999 memo from George Loveland to the Honorable Mayor and City Council re: "Water and Sewer Cost of Service Studies." Mr. Story did not recall seeing it. Mr. Schachter asked if the City applied for SRF loans knowing it was out of compliance. Mr. Story did not know if the City applied for new SRF loans while he worked for the City. Mr. Schachter asked Mr. Story if he discussed whether to inform the State of the City's noncompliance. He did not recall discussing whether to inform the State about noncompliance before accepting new SRF money.

Mr. Schachter asked Mr. Story if he recalled a Council meeting where Councilmember Frye discussed the COS. Mr. Story recalled a Council meeting in mid-2002 where Councilmember Frye said that there was an expectation that the City had to take action on rates and that the COS was delayed. She asked why it was not done and when would the COS be done so she could have it. He did not recall who responded but he said Councilmember Frye was told the COS was still being evaluated. He probably did not attend the meeting but may have seen it on television. Mr. Schachter asked Mr. Story if he discussed this meeting with the Mayor. He did not recall speaking about it with the Mayor or anyone else.

Analyses of Noncompliance

Mr. Schachter asked Mr. Story if he reviewed any legal analysis concerning the rate structure prepared by the City Attorney's Office. Mr. Story said that given the fact that the rate structure change was discussed in Closed Session and that the staff said that there was a mandate to make a change, he assumed the mandate for change was part of a legal analysis. He was not aware of any City Attorney analysis and he could not say that in the briefings with the Mayor, Loveland and Kahlie stated that a change was necessary based on an opinion of the City Attorney's Office.

Mr. Story was shown Exhibit 5, a November 14, 2002 memo from Mary Vattimo and Kelly Salt to the Honorable Mayor and City Council re: "Significant Exposure to Litigation: Metropolitan Wastewater Department's Compliance with Federal and State Loan and Grant Guidelines." Mr. Story was also shown Exhibit 6, a November 11, 2002 memo entitled, "Salient Points." Mr. Story did not recall seeing either and did not believe he had ever seen them before. He was familiar with the points addressed in both documents but did not know when he first became aware of these issues. He could not say he was aware of the issues prior to January 29, 2002. Mr. Schachter asked how it was possible that he had never seen these documents. He responded that if the documents were introduced to the Mayor in the context of potential litigation, he would not necessarily have been included in the briefing.

Disclosure

Mr. Schachter asked Mr. Story whether he was involved in the 2003 sewer revenue bonds. He replied that he was "very peripherally involved" with the 2003 sewer revenue bonds. He was focused on the Mayor's goals, including reducing sewer spills, and it was "not unusual" to have an issue regarding wastewater go forward without review or analysis by him.

Mr. Schachter asked Mr. Story if he knew what a Preliminary Official Statement ("POS") was. Mr. Story did not. He was aware of disclosures being sent to the investing public but never reviewed them. Mr. Schachter asked who in the Mayor's Office received the POS. He responded that he was not sure anyone in the Mayor's Office would have reviewed the POS. Gibson had financial expertise and Story himself was not expected to review financial documents. He did not recall Gibson asking about the regulatory status of the sewer revenue funds. He was not familiar with bond disclosures regarding the state of compliance and never discussed it with anyone.

Pension

Involvement in Labor Negotiations

Mr. Schachter asked Mr. Story about his involvement with labor negotiations and the Blue Ribbon Committee ("BRC"). Mr. Story responded that labor negotiations were Gibson's responsibility and Mr. Story had zero input. The BRC was a Gibson issue.

Blue Ribbon Committee and Pension Rerform Committee

Mr. Schachter asked Mr. Story to discuss his knowledge concerning the BRC. He recalled the BRC being formed and releasing findings regarding the financial condition of the City. Mr. Story recalled the BRC identifying many problems and making recommendations. Some were later followed by the City; others were not. He recalled the BRC identifying vulnerabilities which led to the creation of a Pension Review Committee ("PRC") which examined pension underfunding. Mr. Story recalled the PRC made a substantial effort and that April Boling was heavily involved. He volunteered that Boling did not let her support for Mayor Murphy get in the way of "blasting the administration" regarding problems with the pension system. Mr. Story said that Boling's comments were not always appreciated but she was not influenced by her political position. She thought underfunding was a vulnerability that needed to be addressed as soon as possible. He did not participate in any meetings regarding underfunding and did not have any meetings with the Mayor regarding underfunding. He had his "hands full with other issues."

Mr. Schachter asked Mr. Story if he was aware that the BRC's findings were delayed until after the Ballpark financing took place. Mr. Story was aware that the BRC's findings were delayed until after the Ballpark financing but he was not aware that the financing caused the delay. Because of 9/11, the City's priorities changed overnight and where Mayor Murphy spent his energies changed as well. Mayor Murphy needed to demonstrate leadership on security issues. Mr. Schachter asked Mr. Story how 9/11 impacted the BRC. Mr. Story admitted that he had no knowledge of the impact of 9/11 on the issuance of the BRC report. He recalled that when the BRC's findings came out, pension funding was one of the issues addressed.

Knowledge of Pension Benefits & MP2

Mr. Schachter asked Mr. Story to discuss his knowledge of pension benefits issues in the City. He did not participate in any discussions regarding increasing retirement benefits or about whether underfunding of the pension system impacted the decision to increase benefits. He was familiar with MP2 today and said MP2 was a proposal to allow the trigger for full funding to be lowered to 80% from 82.5% and was tied to a budget agreement and formula for credit of time. Mr. Schachter asked Mr. Story if he discussed pension underfunding with Gibson or Mayor Murphy. He did not recall specific discussions with Gibson or the Mayor's staff regarding remedying the underfunding of the pension system but would have overheard discussions while he waited to see the Mayor.

Mr. Schachter asked Mr. Story if he recalled discussing the propriety of MP2 with Mayor Murphy. Mr. Story did not have any discussions with Murphy about the propriety of MP2 but did discuss MP2 with Mayor Murphy the afternoon of its passage. Mayor Murphy

expressed pleasure with solving the problem and Mayor Murphy said that it was a "good deal" for both the City and the employees. The Mayor had worked hard "to secure consensus among Council members" for MP2's passage. The Mayor referred to lowering the trigger as an important aspect of MP2. Story recalled this discussion with the Mayor occurring in the Mayor's Office.

Ron Saathoff

Mr. Schachter asked Mr. Story to discuss his knowledge of Ron Saathoff (President of the Firefighter's Union; SDCERS Board Trustee) and Saathoff's influence on the SDCERS Board. He had no recollection of conversations with anyone regarding Saathoff's influence or SDCERS giving Saathoff benefits. He said that he knew nothing of the particulars of presidential benefits.

Disclosure

Mr. Schachter asked Mr. Story if he recalled the issue of pension disclosure becoming an important issue. Mr. Story recalled that the need for disclosure of the status of the pension became a topic of discussion and received press coverage. He did not recall any specific discussions but recalled it was an issue gaining traction. Mr. Schachter asked Mr. Story if he discussed with Mayor Murphy who to blame for the pension situation. He did not recall discussions with the Mayor or anyone in the Mayor's Office regarding who was to blame for the pension situation. Mr. Story did not know much more about the pension crisis than what was said in the newspapers but recalled it being explained to Council as a minor omission and error. It was later revealed to the Council as "not so minor." Mr. Schachter asked Mr. Story if he discussed with Mayor Murphy how the errors had originally been characterized as minor. Mr. Story did not recall.

Illegal Acts

Mr. Schachter asked Mr. Story if there was anything beyond the subjects discussed today where Mr. Story reached the belief that someone in City government did something that they should not have done. Mr. Story heard of "nothing relevant to the scope of the investigation." He said he is aware of someone breaking the law. He said "a lot of shit happened" during the 19 years he worked for San Diego. He is "not aware of any illegal acts related to any questions raised today." He said "there is not a person who worked in the City today who could answer 'no'" to the question of whether he is aware of anyone in City government breaking the law. Ms. McAteer said that Mr. Schachter's questions were "beyond the scope" of the investigation and were "far afield."

After a brief recess during which Mr. Story consulted with Ms. McAteer, Ms. McAteer stated that Mr. Story's awareness of illegal acts fell into two categories: 1) very public situations, like those reported in the newspaper; and 2) individual employees who committed malfeasances in the civil service system for which Mr. Story has an obligation to protect the confidentiality of their civil service issues. Mr. Schachter asked Mr. Story if he was aware of any current City employees breaking the law. Mr. Story said "no." Mr. Schachter asked Mr. Story if he was aware of any violations involving financial reporting matters. Mr. Story said "no."

Mr. Schachter asked Mr. Story if he knew of any other issues he thought we should know about. Mr. Story said "no." Mr. Schachter requested that if Mr. Story recalled any new information or would like to change his answers, he should contact us.

WF&G

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EXHIBIT 1

567927

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [40A4D739.TRINITY.FIR.100.179637A.1.14D9.1]
From: [Dick Murphy]
To: [;John Kern;JKern@sandiego.gov]
Subject: [Fwd: COD/BOD - Please help us!]
Creation date: [5/14/2004 2:27:05 PM]
In Folder: [cost of service]
Attachment File name: [c:\44932fir\JKern\735.1-GW.MESSAGE.MAIL.Internet]
Message: [

]

567926

Email message text
Object type: [GW.MESSAGE.MAIL.Internet]
Item Source: [Received]
Message ID: [40A4D739.TRINITY.FIR.200.2000002.1.8166.1]
From: ["Wilbur, Kimberly" <KWilbur@ispcorp.com>]
To: [;Dick Murphy;DickMurphy@sandiego.gov]
Subject: [COD/BOD - Please help us!]
Creation date: [5/14/2004 2:03:04 PM]
In Folder: [cost of service]
Attachment File name: [c:\44932fir\JKern\735.1.1-TEXT.htm]
Attachment File name: [c:\44932fir\JKern\735.1.2-Mime.822]
Message: [
May 14, 2004

Mayor Dick Murphy
202 "C" Street, 11th floor
San Diego, CA 92101

RE: COD/BOD Charges

Dear Mayor Murphy:

On January 21, 2004, ISP, along with CPKelco held a fundraiser for your campaign and raised a significant amount of money. Now, we are in desperate need of your assistance. The impending increase in sewer charges, specifically COD/BOD is now threatening the future of our manufacturing facility.

ISP along with CPKelco employees approximately 350 people and bring a significant amount of business to the Barrio Logan. I don't know if you know, but ISP is going to be celebrating its 75th anniversary this year - 75 years of manufacturing in San Diego County! I think that is pretty significant in this day and age.

You are probably asking what you can do to help us. Well, it is really simple - I am asking you to put pressure on the City Manager to request additional time from the State and request that the State Water Resources Control Board rescind the deadline so that a method that is fair to everyone can be developed.

The increases will have an extremely negative affect, raising our costs to an unaffordable level, not only for ISP, but for several others in the immediate area and at least two of them will probably close down. Additionally, we cannot overlook all those who live in apartment complexes who will no longer be able to afford to live in San Diego due to the

increases they will incur.

San Diego has a secondary treatment waiver but despite this, the State has issued a deadline for us to comply with the COD/BOD charges. The method the city staff developed for charging, double charges the COD/BOD for ISP. This would add approximately $1 million dollars to our costs each year!

The approved method charges for soluble COD/BOD even though the treatment plant does not remove it. These increases could likely cause several businesses to close down, which would dramatically increase San Diego's unemployment rate.

Our position on this issue has the support of our labor union, International Union of Operating Engineer, Local 501, the San Diego Labor Council, the Chamber of Commerce, the Restaurant Association, the Industrial Environmental Association and many other stakeholders.

ISP and our neighbors are working to develop a fair method, but we need more time. We need you to put pressure on the City Manager to request additional time for the State and request that the State Water Resources Control Board rescind the deadline so that a fair method can be developed.

Sincerely,

Kimberly A. Wilbur
Mgr., Human Resources & Training
International Specialty Products

Kimberly A. Wilbur
ISP - Mgr., Human Resources
(619) 557-3126

]

EXHIBIT 2

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [40A895D8.TRINITY.FIR.100.1397868.1.6872.1]
From: [Tom Story]
To: [;Rossana Burgess;RBurgess@sandiego.gov]
Subject: [Fwd: Re: COD/BOD - Please help us!]
Creation date: [5/17/2004 10:37:12 AM]
In Folder: [Mail Box]
Attachment File name: [c:\44932fir\TStory\9330.1-TEXT.htm]
Attachment File name: [c:\44932fir\TStory\9330.2-GW.MESSAGE.MAIL]
Message: [
pls add Kimberly's contact info to GW
]

583180P

583094
Wastewater Hot 3-20-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [40A895D8.TRINITY.FIR.200.2000017.1.9A9B.1]
From: [John Kern]
To: [;Wilbur, Kimberly;KWilbur@ispcorp.com;Doug Sain;doug@saincommunications.com;Tom Story;TStory@sandiego.gov]
Subject: [Re: COD/BOD - Please help us!]
Creation date: [5/14/2004 8:15:55 PM]
In Folder: [Mail Box]
Attachment File name: [c:\44932fir\TStory\9330.2.1-TEXT.htm]
Message: [
Dear Ms. Wilbur.

While we appreciate the support of ISP and CPKelco, the fact that they held a fundraiser for the Mayor does not, and will not, influence his position on this issue.

We are well aware, through Mr. Sain, of the interest in an extension and we have communicated with Mr. Sain that the State has told us that they want us to deal with this issue now and they are not interested in us asking for an extension.

The person most knowledgeable on this issue on our staff is Tom Story and I urge you to discuss this with him. His number is 619-236-6568.

John Kern
Chief of Staff
Mayor Dick Murphy
619.236.7795

>>> "Wilbur, Kimberly" <KWilbur@ispcorp.com> 05/14/04 02:03PM >>>

st1\:*{behavior:url(#default#ieooui) }May 14, 2004 Mayor Dick Murphy
202 "C" Street, 11th floor
San Diego, CA 92101 RE: COD/BOD Charges Dear Mayor Murphy: On January 21, 2004, ISP, along with CPKelco held a fundraiser for your campaign and raised a significant amount of money. Now, we are in desperate need of your assistance. The impending increase in sewer charges, specifically COD/BOD is now threatening the future of our manufacturing facility. ISP along with CPKelco employees approximately 350 people and bring a significant amount of business to the Barrio Logan. I don't know if you know, but ISP is going to be celebrating its 75th anniversary this year - 75 years of manufacturing in San Diego County! I think that is pretty significant in this day and age. You are probably asking what you can do to help us. Well, it is really simple - I am asking you to put pressure on the City Manager to request additional time from the State and request that the State Water Resources Control Board rescind the deadline so that a method that is fair to everyone can be developed. The increases will have an extremely negative affect, raising our costs to an unaffordable level, not only for ISP, but for several others in the immediate area and at least two of them will probably close down. Additionally, we cannot overlook all those who live in apartment complexes who will no longer be able to afford to live in San Diego due to the increases they will incur. San Diego has a secondary

treatment waiver but despite this, the State has issued a deadline for us to comply with the COD/BOD charges. The method the city staff developed for charging, double charges the COD/BOD for ISP. This would add approximately $1 million dollars to our costs each year! The approved method charges for soluble COD/BOD even though the treatment plant does not remove it. These increases could likely cause several businesses to close down, which would dramatically increase San Diego's unemployment rate. Our position on this issue has the support of our labor union, International Union of Operating Engineer, Local 501, the San Diego Labor Council, the Chamber of Commerce, the Restaurant Association, the Industrial Environmental Association and many other stakeholders. ISP and our neighbors are working to develop a fair method, but we need more time. We need you to put pressure on the City Manager to request additional time for the State and request that the State Water Resources Control Board rescind the deadline so that a fair method can be developed. Sincerely, Kimberly A. WilburMgr., Human Resources & Training International Specialty Products Kimberly A. WilburISP - Mgr., Human Resources(619) 557-3126

]

EXHIBIT 3

CITY OF SAN DIEGO
MEMORANDUM

DATE: November 22, 2002

TO: Honorable Mayor and City Council

FROM: P. Lamont Ewell, Assistant City Manager

SUBJECT: Transmittal of Draft Sewer Cost of Service Study

The attached draft Sewer Cost of Service and Rate Design Study dated May 2002 is being distributed for your information.

The document is not in final form. Therefore, the reader is cautioned that it was and is a *draft* which will require substantial updating and revision prior to considering any or all of the recommendations contained therein. The underlying data reflects 1999 actuals and projections.

Questions concerning the draft study should be directed to Dennis Kahlie, Utilities Finance Administrator, at 235-5832.

P. Lamont Ewell

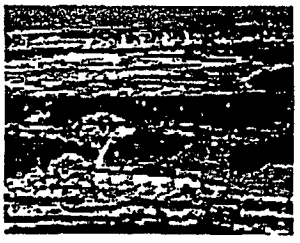
DHK

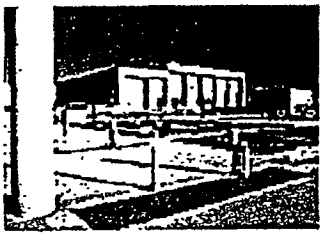
Attachment: Draft study dated May 2002

R E P O R T

DRAFT

Sewer Cost of Service and Rate Design Study





METROPOLITAN WASTEWATER DEPARTMENT

DRAFT

May 2002

SP_SEC_SC002382-2572 (Peters)

BLACK & VEATCH
Corporation

DRAFT

Table Of Contents

Section 1
Executive Summary

The City of San Diego (City) wanted to conduct a comprehensive cost of service and rate design study (Study) that includes a review of revenue requirements, user classifications, costs of service, and the design of a system of user charges for the City's wastewater service. In addition, the City also desired a review of its existing capacity fees. This report documents the results of the Study, recommends changes to user classification and cost allocation, and proposes wastewater rates that the City should charge its retail customers beginning March 1st, 2002, or as soon as feasible thereafter.

The City provides both wholesale wastewater services to the Participating Agencies (PAs) and retail service to the City's users. The City is partially financing its capital projects through a combination of federal loans and grants, which are administered by the State Water Resources Control Board (SWRCB). As a recipient of various federal grants and state loans, the City is obligated to comply with SWRCB's Revenue Program Guidelines. In order to be consistent with the Revenue Program requirements, SWRCB is mandating that the City modify its existing cost allocation basis and include the Chemical Oxygen Demand (COD) parameter in its rate structure.

The focus of this Study is primarily on the City's retail wastewater service. The specific objectives of this Study include:

- Review of the costs of providing regional wastewater collection, conveyance, treatment and disposal services to the City's users and to the PAs outside the City's retail service area.
- Determination of costs of service for the City's retail service area.
- Allocation of costs of service to the wastewater parameters of Flow, Total Suspended Solids (TSS) and COD.
- Allocation of parameter costs to the City's retail service user classes.
- Design of a system of user charges including wastewater user charges and capacity fees.

The following sections present a documentation of the cost of service review and analysis findings and the recommendations of the study.

REVIEW FINDINGS

This section of the Executive Summary provides a brief background of the wastewater system, a review of the revenue requirements and user classifications, an evaluation of issues, an analysis of cost of service, and the design of wastewater rates and capacity fees.

Wastewater System

System Infrastructure: The City owns and operates a regional wastewater system that includes both the Municipal (Muni) System and the Metro System. The Muni System is primarily a sewage collection system that serves the City's service area. The Metro system includes advanced primary treatment, tertiary reclamation, sludge processing facilities, and an ocean outfall. For the regional system, the City holds a NPDES permit that stipulates discharge limitations. The City provides wastewater service to 15 PAs pursuant to the terms of the Regional Wastewater Disposal Agreement.

Existing Rate Structure: The City's existing wastewater rate structures for the Single Family Residential (SFR), Multi-Family Residential (MFR) and Commercial/Industrial user classes include a fixed Base Fee and a Usage Rate. The Base Fee varies by user class. The MFR and commercial/industrial users have the same monthly base fee of $0.51 per meter. SFR users have a much higher monthly base fee of $8.77. These fees are effective as of March 1, 2001.

The current SFR usage rate effective as of July 1, 2001 is $3.0481 per hundred cubic feet (hcf) of water usage. The bi-monthly SFR usage charges are determined by applying the SFR usage rate to a user's 30-day average winter water usage with a usage cap of 10 hcf. The MFR users are charged based on monthly water usage but with flows estimated at a 95 percent return to sewer.

The existing rate schedule for the commercial/industrial users is in the form of a 10x20 TSS/Return to Sewer matrix with 200 user rates. The rate applied to a user's monthly water usage depends on the user's TSS strength and percent return to sewer. Rates for Commercial/Industrial users that have TSS strengths greater than 1,000 mg/l, are computed individually and adjusted for percent return to sewer.

Review of Revenue Requirements

The City's principal sources of operating revenues are the sewer service charges from the City's users and the full cost recovery revenues from the PAs per their cost sharing agreements with the City. The primary sources of capital revenues include sewer connection fees, capital fund balance, bond proceeds, state and federal grants & loans, capacity fees from the City and the PAs, pay-as-you-go revenues from the PAs, and interest earnings.

The City estimates overall annual wastewater Operation and Maintenance (O&M) expenditures in the range of $173 - $198 million during FY 2001 through FY 2005. The City's retail service area O&M expenditures, which are the focus of this Study, are estimated to be in the range of $148 to $168 million. Existing debt service requirements during the study period include annual payments in the range of $77 to $99 million. During the study period FY 2001 to FY 2005, the total wastewater Capital Improvement Program (CIP) is estimated at nearly $618 million.

In order to meet projected revenue requirements and to maintain desired operating and debt service reserve funds, the City proposed the following revenue adjustments, which were approved by the City Council on October 16th, 2001:

Effective Date	Increases
March 1, 2002	7.5 percent
March 1, 2003	7.5 percent
March 1, 2004	7.5 percent
March 1, 2005	7.5 percent

Issues Examined

This Study involved extensive participation of a Stakeholder Group (Group). The four major issues that were examined and for which stakeholder input was obtained include: Compliance with SWRCB regulatory requirements, classification of commercial/industrial users, allocation method used to

allocate costs to the wastewater parameters of flow, TSS and COD and rate structure alternatives.

Cost of Service

The total FY 2002 cost of service to be recovered from the City's retail users is estimated at nearly $194 million, of which $130 million is operating costs and the remaining $64 million are capital costs.

The cost of service allocations conducted in this study are based on the functional-design method that was approved by the PAs and SWRCB. The revenue requirements are allocated to the different user classes proportionate to their use of the wastewater system. As required by SWRCB, allocations are based on flows, TSS and COD parameters. The cost of service allocation performed for the City's retail service area users is consistent with the system-wide proportionate use approach used in allocating revenue requirements between the City and the PAs.

Rate Design

The rate structures designed in this Study incorporate the COD parameter as required by the SWRCB and provide for a system of user charges that result in fair and equitable recovery of costs from the various user classes.

STUDY RECOMMENDATIONS

This section of the Executive Summary outlines our recommendations. The proposed changes include various aspects of the study including user classification, cost allocation, wastewater rate structures and capacity fees.

Proposed User Classification

We recommend that the City continue its existing classification of SFR and MFR users. However, to ensure compliance with SWRCB user classification requirements and to facilitate the incorporation of COD into the rate structure, we recommend that changes be made to the existing commercial/industrial user classifications.

The SWRCB user classification guidelines stipulate that costs must be allocated individually to large commercial users discharging more than 25,000 gpd. Therefore, we recommend that commercial/industrial users with greater than 25,000 gpd of wastewater discharge be categorized as large users and rates be individually calculated for these users. The City currently has nearly 150 large users.

We recommend that the City's commercial/industrial users that discharge less than or equal to 25,000 gpd of wastewater flows be classified and billed for service using a user class matrix that is based on TSS and COD wastewater parameters instead of the current TSS/Return Factor parameters. We recommend that the return to sewer percentage be directly applied to each user's metered water consumption (to estimate wastewater flows) during sewer bill computations.

Cost Allocation

We recommend the continued use of the functional-design method in allocating costs to the wastewater parameters of flows, TSS and COD and the allocation of costs to the user classes proportionate to their use of the wastewater system.

Comparing revenues under the proposed rate structure and the current rate structure after the 7.5 percent revenue adjustment in March 2002, there is a small decline in MFR annual revenues under the proposed rate structure. Similarly, estimated FY 2002 SFR user revenues, as a percentage of total user revenues, are about two percent lower under the proposed rate structure than under the current rate structure. These decreases in residential revenues are offset by an increase in the commercial/industrial user class revenues. This shift in user class revenue distribution between the residential and commercial/industrial user classes is directly attributable to the introduction of the COD parameter in the cost of service allocation process, and the fact that many commercial/industrial businesses such as supermarkets, food processing and organic chemical industries and restaurants have much higher COD strengths than residential users.

Rate Design

Black & Veatch recommends the continued use of a rate structure that includes both a fixed monthly base fee and a variable water usage charge.

Base Fee: With respect to base fees, we recommend that the City establish a uniform monthly base fee for all users instead of the existing method of varying base fees. Of the three base fee options examined, as selected by the stakeholder group, we recommend maintaining the base fee under $10.00 since a higher base fee would adversely impact users that have low water/sewer usage. Therefore, we recommend a monthly base fee of $9.93 for FY 2002 for all users.

Residential Usage Rate: We recommend that the City continue its existing method of computing bi-monthly SFR wastewater charges, but with a usage cap of 14 hcf instead of the existing 10 hcf cap. Three different usage cap alternatives were examined and based on stakeholder group input, we recommend a usage cap of 14 hcf. The mass balance analysis also indicates a need for a higher usage cap. We recommend that the City continue its existing method of determining bi-monthly user charges based on a 30-day average winter water usage and continue to estimate MFR wastewater usage charges based on monthly water usage. Table ES-1 presents a summary of the Residential Rate Schedule.

Commercial/Industrial Usage Rate: For commercial/industrial users that discharge less than 25,000 gpd of flows, we recommend that the City establish a two-dimensional rate matrix based on TSS and COD strength ranges. The wastewater rates are computed for each TSS/COD strength range based on the mid-point strength of the range. Table ES-2 presents the commercial/industrial rate matrix.

Wastewater charges for Commercial/Industrial users discharging greater than 25,000 gpd of flows are calculated individually based on cost of service unit rates. The cost of service unit rates are as follows: Flow - $2.1403 per hcf, TSS - $0.3652 per lb and COD - $0.1303 per lb. The total monthly charges are computed using these unit rates and include a monthly base fee of $9.93.

TABLE ES-1 SUMMARY OF RESIDENTIAL RATE SCHEDULE (FY 2002)

Description	Usage Rate $/hcf
SFR Usage Rate ($/hcf of Water) (1)	$2.22
MFR Usage Rate ($/hcf/Water)	$2.77

NOTE
(1) Rate based on a usage cap of 14 hcf.

TABLE ES-2 COMMERCIAL/INDUSTRIAL MATRIX USERS RATE MATRIX (FY 2002)

(mg/l)		TSS 0-100	TSS 101-200	TSS 201-300	TSS 301-400	TSS 401-500	TSS 501-600	TSS 601-700	TSS 701-800	TSS 801-900	TSS 901-1000
COD	COD	A	B	C	D	E	F	G	H	I	J
0-200	AA	$2.270-	$2.493	$2.715	$2.938	$3.161	$3.384	$3.607	$3.830	$4.053	$4.275
201-400	BB	$2.434	$2.657	$2.880	$3.102	$3.325	$3.548	$3.771	$3.994	$4.217	$4.440
401-600	CC	$2.598	$2.821	$3.044	$3.267	$3.490	$3.712	$3.935	$4.158	$4.381	$4.604
601-800	DD	$2.762	$2.985	$3.208	$3.431	$3.654	$3.877	$4.100	$4.322	$4.545	$4.768
801-1000	EE	$2.927	$3.149	$3.372	$3.595	$3.818	$4.041	$4.264	$4.487	$4.709	$4.932
1001-1200	FF	$3.091	$3.314	$3.537	$3.759	$3.982	$4.205	$4.428	$4.651	$4.874	$5.097
1201-1400	GG	$3.255	$3.478	$3.701	$3.924	$4.147	$4.369	$4.592	$4.815	$5.038	$5.261
1401-1600	HH	$3.419	$3.642	$3.865	$4.088	$4.311	$4.534	$4.756	$4.979	$5.202	$5.425
1601-1800	II	$3.584	$3.806	$4.029	$4.252	$4.475	$4.698	$4.921	$5.144	$5.366	$5.589
1801-2000	JJ	$3.748	$3.971	$4.194	$4.416	$4.639	$4.862	$5.085	$5.308	$5.531	$5.754
2001-2200	KK	$3.912	$4.135	$4.358	$4.581	$4.803	$5.026	$5.249	$5.472	$5.695	$5.918

NOTE: (1) The rate for each TSS/COD range is calculated based on mid-point loading of the range.

Rate Impact

The main objective of this Study is to ensure a fair and equitable allocation of costs to all th classes in proportion to their demand for wastewater services. The combination of changes proposed, including user reclassification, introduction of COD and the establishment of uniform base fee provide for a fair and equitable allocation of costs among the City's user classes.

The cost of service analysis indicates that under the existing method where the allocations and rate structures are based only on Flow and TSS parameters, some users have been paying less than their fair share while others have been contributing more than their fair share. This study, which incorporates the COD parameter in both the allocation of costs and in the design of rate structures, reassigns revenue

requirements among the various user classes so as to facilitate fair and equitable cost recovery.

The impacts discussed in this paragraph compare the March 2002 rates under the existing and proposed rate structure. All SFR users will benefit under the new rate structure. The degree of benefit varies depending on the winter water usage from 3 percent to 24 percent. MFR accounts with usage lower than 67 hcf per month will experience increases in their sewer service charges due to the impact of a substantially higher base fee. Commercial/industrial user class revenue may increase or decrease depending on discharge strength and volume. While the proposed changes lead to increases in wastewater charges for some users and decreases for others, they ensure a fair and equitable allocation that is proportionate to use. In addition, all aspects of the Study including identification and aggregation of O&M and capital costs, classification of users, allocation of costs and the development of rate structures conform to the revenue program guidelines set forth by the SWRCB.

Capacity Fees

Capacity (developer) fees are one-time fees used to recover some or all of the cost of providing the system capacity required when a new user connects to the wastewater system. Examples of such costs include those related to increasing transmission and treatment capacity in treatment plants, ocean outfalls, interceptors, pumping stations, and sewer mains.

The City currently charges $2,500 per equivalent dwelling unit (EDU) or SFR. The minimum capacity assigned to any sewer connection is one EDU. MFR units having individual, City-read water meters are assigned one EDU per unit, while MFR units that share a common water meter are charged based on a density-adjusted formula. Non residential customers are charged based upon the number of fixture units by using a conversion factor that equates 20 fixture units to one EDU.

The City has incurred major costs over the last ten years to upgrade facilities and will continue to incur additional costs to comply with EPA mandates to meet discharge requirements. The growth-related portion of these past and future costs of improvements and upgrades to the City's facilities form the basis of the calculated capacity fee. The capital costs the City has incurred prior to 1997 (some of these costs dated back to 1992 and before) and the future costs to be incurred over the next ten years were reviewed. The projects associated with these capital costs were examined and the net capacity available from these projects was determined in order to derive the capacity fee. These projects include sewer mains, pumping stations, treatment plant upgrades, outfall costs etc. The resultant near-full-cost-recovery capacity fee is $5,353 per EDU.

The City may also wish to consider adding an incremental amount to recover the growth-related portion of system infrastructure costs for facilities constructed prior to 1992. A very conservative engineering estimate for these primary treatment, collection and disposal facilities would be $2 per gallon per day (gpd). This adds another $560 to the calculated capacity fee, yielding a full-cost-recovery capacity fee of $5,913 per EDU.

Implementation of the higher capacity fees discussed above results in additional capacity fee revenue of $11.3 million to $13.5 million in FY 2003, depending on the option implemented. Since these additional dollars would replace funds that would otherwise be supplied by current system users, a one-time reduction in user fee revenue requirement of between 5.7 to 6.8 percent for all customer classes could be provided in FY 2003. In summary, the Council-adopted FY 2003 rate increase of 7.5 percent

would be offset by the rate reduction made possible by the higher capacity fees, resulting in a smaller net rate increase of only 1.8 to 0.7 percent.

Section 2
Introduction

BACKGROUND

The City retained Black & Veatch to conduct a comprehensive cost of service and rate design study to establish a fair and equitable system of user charges for the City's retail wastewater service. This report documents the findings, analyses, results and recommendations of the Study.

The City owns and operates a regional wastewater system that provides wastewater collection, conveyance and treatment services to the City and a number of PAs outside the City. The City operates the regional wastewater system under the federal National Pollutant Discharge Elimination System (NPDES) permit that stipulates standards of discharge. To comply with the discharge standards and to meet other requirements of the Environmental Protection Agency's (EPA) Clean Water Act, the City had to undertake various capital project initiatives including the enhancement of existing wastewater treatment facilities and the construction of new tertiary wastewater reclamation facilities. The City operates the wastewater system as a self-supporting enterprise and costs are accounted for separately under the wastewater enterprise fund.

To minimize the impact of the capital project initiatives on the users of the City and its PAs, the City has been, and is financing its capital projects in part via a combination of federal loans and grants, which are administered by the SWRCB. As a recipient of various federal grants and state loans, the City is obligated to comply with SWRCB's Revenue Program Guidelines. *The guidelines require that recipients of state-administered grants and/or loans establish a system of user charges that recovers operating and capital costs from users on a basis proportionate to use.* The guidelines specifically require a fair and equitable apportioning of costs based on each user class's contributions of flow and strength of wastewater pollutants discharged.

To comply with the revenue program guidelines, the City conducted a review of cost of service and developed a strength-based billing method to allocate costs among the various PAs and the City. The strength-based billing procedure, which is based on flow and the strength parameters of TSS and COD, was approved by the SWRCB in 1998. The PAs are currently billed based on their contribution of flow, TSS and COD as per the terms outlined in the service contracts between the City and the PAs.

However, the user charge system that is applied within the City's municipal service area is presently based only on Flow and TSS and does not include the COD parameter. Consistent with revenue program requirements, SWRCB is mandating that the City modify its existing cost allocation basis and include the COD parameter in its rate structure. Therefore, the City requested a comprehensive cost of service study that includes a review of City's projected revenue requirements, allocation of costs to strength and flow parameters, development of unit costs and design of rate schedules for the various user classes.

OBJECTIVES

Several interrelated objectives need to be considered in the development of a financial plan and in the design of rates. This being the case, judgement plays a role in the final design of rate structures and rates. The major objectives of the study are:

- Ensure *Revenue Sufficiency* to meet the operation and maintenance (O&M) and capital costs of the City's wastewater enterprise
- Plan for *Revenue Stability* to provide for adequate operating and capital reserves and the overall financial health of the wastewater enterprise
- Maintain good *Financial Ratings* by providing for a stable and reliable financial position so that debt issuance can be achieved at the lowest cost
- Ensure *Fairness and Equitability* in the development of a system of user charges
- Minimize *Rate Impact* to reduce financial hardship on the different user classes
- Enhance *Public Understanding of the Rate-Setting Process* through stakeholder participation
- Ensure *Compliance* with regulatory requirements of the SWRCB

SCOPE OF THE STUDY

The scope of this study involves the determination of *Wastewater User Rates* through a comprehensive cost of service and rate design study, determination of *Capacity Fees* and obtaining the approval of the SWRCB. While User Rates facilitate the generation of adequate revenues to meet routine annual O&M and capital expenditures including debt service, Capacity Fees ensure that new users pay their fair share of costs so that existing users are not burdened with providing capacity for new users.

The comprehensive cost of service and rate design component includes three major processes. Figure 2-1 provides a graphical representation of the various steps involved in the comprehensive cost of service and rate design process. The three major processes are as follows:

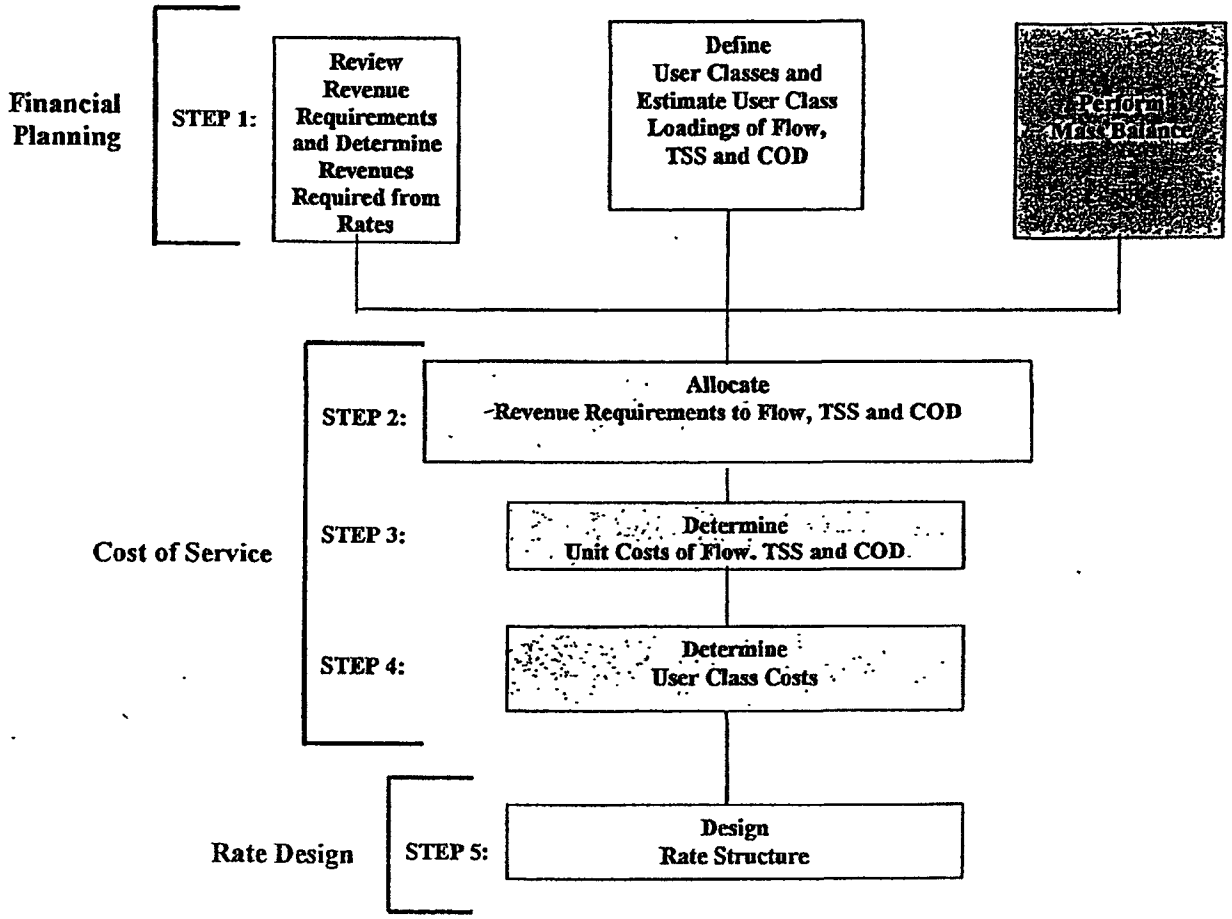
- **Financial Planning:** Revenue requirements are projected for a five-year period from FY 2002 through FY 2006. Financial planning involves estimation of annual O&M and capital expenditures, annual debt service and reserve requirements, operating and capital revenue sources and the determination of required annual user revenues from rates and charges. User classification, annual user loadings estimation for the selected wastewater parameters, and mass balance are also performed concurrently.

- **Cost of Service:** Cost of Service involves the apportioning of annual revenues required to the different user classes proportionate to their contributions of flow, TSS and COD to the wastewater system.

- **Rate Design:** Rate Design involves the development of a fixed and variable schedule of rates for each of the different user classes to equitably recover the costs attributable to them.

The Capacity Fee development component includes the determination of wastewater infrastructure capacity and the associated costs required to accommodate new growth, and the design of one-time capacity fees for the different classes of new users.

FIGURE 2-1 COST OF SERVICE / RATE DESIGN PROCESS



ASSUMPTIONS USED IN THE STUDY

Following are the assumptions used in the study:

1. Annual O&M and capital expenditures, annual revenues from the PAs, other revenue sources and reserve requirements, O&M inflation factors and user account growth projections are all based on the City's Fiscal Year 2000 *Rate Case*.

2. Annual average wastewater system Flow and TSS/COD concentrations used in the Mass Balance Analysis are based on the Metropolitan Wastewater Department (MWWD)'s annual report on projected flows and strength. The data used in the Study is from the *Projected Flow and Strength Report (FY 2000)*.

Section 4
User Classification and Loadings

One of the major tasks in the cost of service and rate design process is the classification of the users of the wastewater system and the determination of annual flows and wastewater loadings (TSS, COD and other wastewater constituents) associated with each class. The existing and proposed classification of the City's users, the estimation of wastewater flows and loadings for each of the proposed user classes and the mass balance analysis are discussed in this section of the report.

SEWER USER CLASSIFICATION

In addition to the 15 PAs, who are the City's "wholesale" users, the City's wastewater enterprise has a mix of "retail" users within the City's service area. The City's retail users primarily comprise regular water/sewer, sewer only and the Department of Navy users. Since the focus of this Study is the City's retail users, discussions on sewer user classification relates exclusively to the users within the City's service area and henceforth these users are referred in this report as "City's Users". A review of the City's existing user classifications, and the proposed changes to the classifications are discussed in the following subsections.

Existing City User Classifications

The City currently serves a population of nearly 1.28 million within the City's service area. As per FY 2000 estimate the City has a total of 259,340 sewer accounts. The breakdown of the City's sewer user classes and the number of accounts associated with each class as of FY 2000, are as follows:

User Class Description	Number of Accounts
Single Family Residential (SFR)	214,860
Multiple Family Residential (MFR)	29,140
Commercial/Industrial	15,340

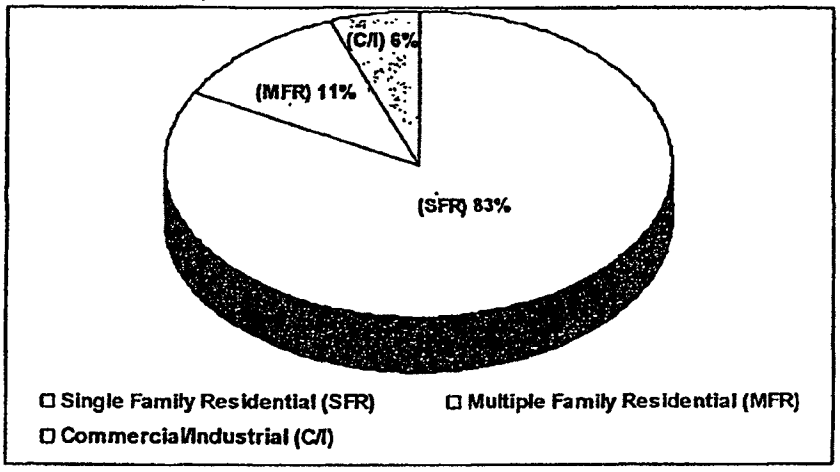
The percentage distribution of the accounts is shown in Figure 4-1. Residential accounts comprise 94% of the total sewer user accounts serviced.

Residential Classification: The City's residential users are classified into SFR and MFR classes. The residential classes are homogenous in that all the users have the same TSS and COD strengths. However, the volume of flows can vary among the users depending on water usage. The residential users are classified into SFR and MFR since they differ in their water usage characteristics. SFR water usage includes significant irrigation usage whereas MFR water usage includes very low irrigation usage.

Commercial/Industrial Classification: Typically, there is significant variability in both the volume of wastewater flows and wastewater strengths, among the different types of commercial/industrial users such as food service establishments, retail stores, and supermarkets. Therefore, to ensure fair and equitable determination of wastewater service charges, the City has developed a commercial/industrial user class matrix based on the two variables of TSS concentration and percent return to sewer. Commercial/Industrial users with a TSS concentration of greater than 1,000 milligrams per liter (mg/l)

are considered as large users and as mentioned in Section 3, their rates are computed individually. The commercial/industrial user classification is discussed further in Section 6.

FIGURE 4-1 – DISTRIBUTION OF SEWER USER ACCOUNTS (FISCAL YEAR 1999-2000)



Proposed User Classifications

Black & Veatch recommends that the City's users be grouped into four broad user classes: SFR, MFR, Commercial/Industrial users with less than or equal to 25,000 gpd discharge, and Commercial/Industrial users with > 25,000 gpd discharge. No classification changes are proposed for the City's SFR and MFR classes. However, we propose changes to the City's Commercial/Industrial user classification in order to be consistent with the SWRCB user classification guidelines and to accommodate the required incorporation of COD parameter in the proposed rate structure.

Commercial/Industrial Classification: In the proposed user classification, the City's commercial/industrial users are classified into two groups:

- Commercial/Industrial users that discharge greater than 25,000 gpd of wastewater flows (henceforth referred to as "Large Users")
- Commercial/Industrial users that discharge less than or equal to 25,000 gpd of flows (henceforth referred to as "Matrix Users")

The classification of Large Users is consistent with the SWRCB user classification guidelines. The guidelines stipulate that costs must be allocated individually to large commercial users discharging more than 25,000 gpd.

In the proposed user classification scheme, the City's Matrix Users, are further classified using a *user class matrix* that is based on TSS and COD wastewater parameters instead of the current TSS/Return to Sewer variables. The return to sewer percentage in the proposed classification would be directly applied to each user's metered water consumption (to estimate wastewater flows) during sewer bill computations.

WASTEWATER FLOW ESTIMATION

In order to perform a cost of service analysis, wastewater flow needs to be estimated and projected for each user class. Wastewater flow is not measured for a vast majority of users because of cost and/or technology concerns. Typically, flows are estimated based on winter water usage for SFR users and as a percentage return of water usage for MFR and most Commercial/Industrial users. Actual wastewater flow is measured for only a few commercial/industrial users.

Residential Class

Black & Veatch reviewed the methods that the City currently uses to estimate annual wastewater flows for the residential class. The City currently uses annualized winter water usage with a usage cap of 10 hcf to estimate wastewater flows for the SFR users and actual monthly water usage to estimate wastewater flows for the MFR users. The methods used in estimating wastewater flows differ between SFR and MFR users due to the differences in their water consumption patterns.

SFR Wastewater Flow Estimation: SFR water consumption includes two types of water usage: domestic use (water used inside the home) and irrigation use (water used in the yard). While the level of domestic water usage is expected to remain fairly stable throughout the year, fluctuation in irrigation usage could occur due to seasonal changes, which in turn causes significant variations in water usage during the year. Irrigation usage is at its minimum levels during the winter period and therefore the water used during the winter period can be associated with domestic usage. Typically, domestic water returns to the sewer system and irrigation water does not. Therefore, for SFR users it is appropriate to use annualized winter water usage as a direct approximation of annual wastewater flows returned to the sewer. The four-month period from December through March is deemed as the SFR winter water usage period.

In San Diego, weather conditions are moderately dry even during winter months, which would result in some level of irrigation water use even during the winter period. To account for winter irrigation usage that does not return to the sewer, the City currently has set a usage cap of 10 hcf per month in estimating and billing annual SFR wastewater flows. The usage cap limits the level of water consumption that is included in sewer billing. Any water usage beyond the usage cap level is deemed as not being returned to the sewer and hence is not included in sewer billing. Black & Veatch performed an analysis that indicates a need for a higher usage cap than the current 10 hcf level. Based on that analysis and feedback obtained from the stakeholder group, we propose a SFR usage cap of 14 hcf instead of the current 10 hcf. The issue of SFR usage cap is discussed in greater detail in Section 6.

MFR Wastewater Flow Estimation: MFR water consumption relates predominantly to domestic use with very little or no irrigation use since most MFR complexes have small green areas. MFR complexes with very large green belts are likely to have separate irrigation water meters. Therefore, MFR water usage levels remain relatively stable throughout the year and it is appropriate to use actual monthly water usage in estimating wastewater flows. However, MFR complexes do have some minimum irrigation

usage, which does not return to the sewer, and therefore generally the City estimates MFR annual wastewater flows to be 95 percent of their annual water usage.

Commercial Class

Wastewater flows for the commercial/industrial users are estimated based on actual monthly water consumption. Water usage patterns vary significantly among the different types of commercial/industrial businesses and therefore the City typically assigns to each user a percent return to sewer. Users whose return to sewer varies significantly from what has been assigned can take advantage of an appeals process to have the return to sewer factor and usage rate reduced.

TSS/COD STRENGTH ASSIGNMENT

The City's existing sewer user classification and rate structures are based on wastewater flows and TSS concentrations. The City currently assigns TSS strengths to the different classes of commercial/industrial users based on SIC codes. The City's Sewer Classification Program Industrial Classification Guidelines List is included as Appendix 4-1. No changes were made to the existing TSS assignments.

Since the proposed rate structure needs to include the COD parameter, Black & Veatch assigned COD strengths based on SIC codes to the different types of commercial/industrial users. A list of SIC codes with the corresponding proposed TSS and COD strengths is included in Appendix 4-2. The COD assigned to the different SIC codes is based on past sampling studies data from the Los Angeles County Sanitation District (LACSD), City of Los Angeles (LA) and SWRCB guidelines. BOD data was obtained from these sources and was then converted to COD strength using a 2.0 conversion factor.

MASS BALANCE ANALYSIS

Black & Veatch used the historical FY 1999 water consumption as the base data to estimate annual wastewater flows and TSS/COD loadings for all user classes. The use of reliable data is critical since these historical flows and loadings are used to project future user class annual flows and strength loadings. Projected flows and loadings are later used in the cost of service analysis (to derive the unit costs of service and user class costs). A mass balance analysis is usually performed to verify the appropriateness of the estimated flows and loadings.

Mass balance is the process of matching and reconciling calculated total annual flows and strength loadings in pounds with the quantities actually received at the treatment facilities. The mass balance analysis takes into consideration other non-user flows such as the infiltration & inflow (I&I) flows that get into the sewer system. I&I flows refers to water other than wastewater that enters a sewer system from other sources including cracked sewer mains, manholes and sewer vents. Variances between the actual flows and loadings received at the treatment facilities and the calculated historical flows and loadings are usually reconciled against the SFR flows and loadings since the flows and loadings from that user class can be compared against industry standards.

The City's share of total annual average flows including I&I flows for FY 1999 is estimated at 119 mgd of which 2 mgd is the estimated I&I flow. When the calculated annual City flow and loadings were

compared with the actual City share (net of I&I) received at the treatment facilities, the analysis indicated a 3.7 percent variance. The calculated flows were higher than the actual City's share of flows received.

The City's measured annual average TSS and COD strengths are 269 mg/l and 610 mg/l respectively. The mass balance analysis on loadings indicated that calculated TSS was 1.2% higher than measured TSS. The calculated COD was 7.3% higher than measured COD.

Black & Veatch adjusted the City's average annual SFR flow estimate from 55 mgd to 50.5 mgd. Similarly, the City's SFR TSS strength estimate was reduced from 275 mg/l to 265 mg/l and the SFR COD estimate was reduced from 550 mg/l to 450 mg/l. With these adjustments to the historical SFR estimates of flows and loadings, Black & Veatch was able to reconcile the variances and achieve a reliable mass balance as presented in the mass balance summary in Table 4-1.

TABLE 4-1 MASS BALANCE ANALYSIS SUMMARY

DESCRIPTION	WASTEWATER FLOW (HCF/YR)	TSS LOADINGS (LBS/YR)	COD LOADINGS (LBS/YR)
Total Calculated City User Flows (HCF/Year)	58,947,931	98,975,653	226,185,436
Estimated City User Flows not discharged to City Facilities	1,854,278	3,104,061	6,208,123
Net Calculated City Flows (HCF/Year) (1)	57,093,653	95,871,592	219,977,313
City's Actual 1999 Flows into the plant (HCF/Year)	58,068,182	96,846,114	219,613,864
City's Estimated 1999 I&I (HCF/YR)	975,936	544,572	726,096
City's Actual 1999 Loadings net of I&I Flows (HCF/YR)	57,092,246	96,301,542	218,887,768
VARIANCE ANALYSIS OF ANNUALFLOWS AND LOADINGS			
Variance between actual and calculated (HCF/YR or LBS/YR)	1,406	-429,950	1,089,545
Variance between actual and calculated (%)	0.0025%	-0.45%	0.50%

(1) Mass Balance perfomed based on calculated annual wastewater flow generation of all user classes.

ANNUAL WASTEWATER FLOWS AND LOADINGS PROJECTION

Annual wastewater flows and TSS/COD loadings need to be projected for each user class to determine each user class' cost of service and wastewater rates. A brief discussion on the method used in estimating user class flows and loadings for FY 2002 follows. User class flows and loadings are projected for the fiscal year, for which cost of service allocations are made and rates are calculated. In this Study, cost of service analysis and rate design is performed for FY 2002.

Table 4-2, summarizes the historical and projected average number of customer accounts and annual wastewater flows for FY 2001 to FY 2005. The projection of customer accounts shown in Table 4-2, is

based upon the assumption that annual growth for most of the City's user classes will continue at the rate of one and one-half percent and there will be no increases in the government users.

The wastewater flows and loadings for FY 2002 for each user class are estimated based on the projected increase in the number of accounts and the current annual wastewater flow and loadings. Wastewater flows are projected to increase proportionately with growth. A summary of projected estimates of user class wastewater flows and loadings is shown in Table 4-3.

TABLE 4-2 HISTORICAL AND PROJECTED NUMBER OF ACCOUNTS

User Class Description	Growth Rate	# Accounts FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Water/Sewer - SFR	1.50%	203,611	206,665	209,765	212,912	216,106	219,348	222,639
Water/Sewer - MFR	1.50%	28,038	28,459	28,885	29,319	29,759	30,205	30,658
Water/Sewer - Commercial/Industrial	1.50%	13,711	13,917	14,125	14,337	14,552	14,770	14,992
Sewer Only - SFR	1.50%	7,623	7,737	7,853	7,971	8,091	8,212	8,335
Sewer Only - MFR	1.50%	305	310	314	319	324	329	334
Sewer Only - Commercial/Industrial	1.50%	284	288	293	297	301	306	311
Gov/Mil - SFR	0.00%	458	458	458	458	458	458	458
Gov/Mil - MFR	0.00%	372	372	372	372	372	372	372
Gov/Mil - Commercial/Industrial	0.00%	988	988	988	988	988	988	988
Water/Sewer Very Large Users (Comind)	1.50%	110	112	113	115	117	119	121
Gov./Mil. Very Large Users	0.00%	35	35	35	35	35	35	35
Total		255,535	259,340	263,202	267,123	271,103	275,142	279,243

TABLE 4-3 PROJECTED FY 2002 WASTEWATER FLOWS AND LOADINGS

User Class Description	Annual Wastewater Flows FY 2002 (HCF)	Annual TSS Loadings FY 2002 (LBS)	Annual COD Loadings FY 2002 (LBS)
Single Family Residential	24,955,925	41,006,578	69,915,241
Multiple Family Residential	18,116,067	29,576,749	50,753,048
Commercial/Industrial Users	16,437,736	29,390,096	108,672,068
Total	59,509,728	99,973,423	229,340,357

Section 5
Revenue Requirements

A review of a utility's revenue requirements is a key first step in the rate design process. The review involves an analysis of annual operating revenues under existing rates, capital revenues, O&M and capital expenditures, transfers if any between operating and capital funds, and operating and capital reserve requirements. This section of the report provides a discussion of the projected revenues, O&M and capital expenditures, capital improvement financing plan, debt service requirements, and the revenue adjustments required to ensure the financial stability of the wastewater enterprise. The wastewater system revenues and expenditures are discussed from a regional system perspective and the discussion on required revenue adjustments relates exclusively to the City's users.

SYSTEM REVENUES

The City's Metropolitan Wastewater Department (MWWD) operates the regional wastewater system. The City derives its required annual operating and capital revenues from a number of sources. The principal sources of operating revenues are the sewer service charges from the City's users and the full cost recovery revenues from the PAs per their cost sharing agreement with the City. Other revenue sources include miscellaneous operating revenues such as Shipboard Waste and Trucked Waste Revenues and other non-operating revenues including revenue transfers from the rate stabilization fund. Capital revenue sources include sewer connection fees, capital funds, bond proceeds, state and federal grants & loans, capacity fees from the City and the PAs, pay-as-you-go revenues from the PAs, and interest earnings.

Black & Veatch reviewed the various sources of operating and capital revenues and the City's financing plan. Table 5-1 presents the details of the operating and capital related revenues including the City and PA user and capital revenues. The footnotes explain the basis for the revenue projections during the study period. The table however does not reflect other available revenues such as interest earnings, rate stabilization transfers, bond proceeds and capital grant monies. The comprehensive operating and capital flow of funds statements presented at the end of this section includes all those other revenues.

SYSTEM EXPENDITURES

To provide for the continued operation of the City's regional wastewater system on a sound financial basis, the revenues generated must be sufficient to meet the revenue requirements or cash obligations of the system. Revenue requirements include O&M expenses, capital improvement program (CIP) expenditures, principal and interest payments on existing debt, and other obligations. The wastewater enterprise's annual expenditures include two major components: the Muni and the Metro. Muni relates essentially to the collection system in the City's own retail service area and Metro relates to treatment and disposal services shared both by the City and the PAs.

The City's Financing Services Division annually receives O&M and capital expenditures information for the Metro component from MWWD. Financing Services incorporates these costs with the Muni annual O&M and CIP expenditures and develops comprehensive O&M and CIP cost projections for the entire wastewater enterprise as part of its annual "Rate Case" development.

Section 6
Study Issues/Stakeholder Input

As the graphical representation of the cost of service and rate design process indicates in the introductory section of this report, once the revenue and service requirements are determined, the next critical step in the process is the allocation of revenue requirements to the wastewater parameters. The allocation of costs and the design of rate structures are of particular significance in this Study due to the introduction of COD as an additional parameter in the allocation of costs and in the rate structure. Since stakeholder participation and input is an important element of this study, several issues pertaining to cost allocation methods and rate structure alternatives were discussed with the stakeholder group. It is essential to highlight the important issues that were examined and the stakeholder contributions to those issues since they provide the framework for the cost of service and rate design discussions presented in Sections 7 and 8.

ISSUES

The issues examined in this study can be classified into the following four major areas:

- SWRCB Regulatory Requirements
- Sewer User Classification
- Cost Allocation
- Rate Structure Design

The issues mentioned above are highly interdependent and hence both the analysis and the results of each of the issues have to be examined in terms of the potential impact on each other.

SWRCB Regulatory Requirements

The City has received federal and state Clean Water Grant (CWG) funds and State Revolving Fund (SRF) loans for the construction of wastewater treatment facilities. As a recipient of the federal grants and state loans, the City is obligated to establish a revenue program that complies with the revenue program requirements set forth by the SWRCB. One of the specific conditions that the City agreed to meet when it accepted the federal grant funds was to include strength-based billing in addition to flow-based billing. In compliance, the City established a flow and strength based billing for the PAs in 1998. Since 1998, the City has been billing all the PAs on the basis of flow, TSS and COD parameters.

However, the City continues to bill its own retail service area users only on the basis of flow and TSS and has not included COD into its billing structure. The SWRCB has now required the City to include either BOD or COD in its sewer billing. Since COD is easier to measure, the City has agreed to incorporate COD into the rate structure instead of BOD. Incorporation of COD into the sewer rate structure is not an issue of choice, but a mandatory regulatory requirement that the City needs to comply with.

The SWRCB provides guidelines that enable grantees and loan recipients to develop a revenue program that complies with its requirements. The guidelines include various aspects of a revenue program's development, including revenue requirements determination, user classification, cost allocation and

implementing ordinances. The SWRCB's guidelines on user classification and cost allocation have direct implications on this study.

User Classification

The SWRCB's guidelines on the identification of users state that,

> ".....the users of the treatment works and their associated wastewater flows and loadings (BOD_5, SS or other appropriate constituents) must be identified. Flows and loadings must be documented ...., in order that proportional costs can be calculated."

In the City's existing method, the residential users are classified into SFR and MFR user classes. The commercial/industrial users are classified into a user matrix of 200 discrete classes based on the users' percentage of water returned to sewer and the strength of TSS parameter. The users are assigned a characteristic TSS depending on the type of business activity and return to sewer percentage. The existing user matrix has 10 TSS classes with TSS range from 0 to 1,000 mg/l, increasing in 100 mg/l increments. The matrix has 20 return to sewer classes with the first 19 classes having a range from 5 to 99 percent with return to sewer increasing in four percentage increments. The twentieth class's return to sewer is equal to the metered water use. Figure 6-1 shows this 10x20 matrix with the rates projected for the 7.5 percent increase in March 2002 under the current rate structure.

FIGURE 6-1 PROJECTED COMMERCIAL/INDUSTRIAL USER CLASS MATRIX

Return to Sewer	TSS 50 A	TSS 150 B	TSS 250 C	TSS 350 D	TSS 450 E	TSS 550 F	TSS 650 G	TSS 750 H	TSS 850 I	TSS 950 J
100%	$2.54	$2.85	$3.14	$3.42	$3.73	$4.01	$4.31	$4.59	$4.89	$5.18
95-99%	$2.47	$2.77	$3.04	$3.32	$3.61	$3.89	$4.17	$4.45	$4.75	$5.02
90-94%	$2.34	$2.62	$2.89	$3.14	$3.43	$3.69	$3.97	$4.12	$4.30	$4.76
85-89%	$2.22	$2.48	$2.73	$2.98	$3.24	$3.49	$3 71	$4.00	$4.26	$4.50
80-84%	$2.08	$2.34	$2.57	$2.70	$3.06	$3.29	$3.53	$3.77	$4.01	$4.25
75-79%	$1.96	$2.20	$2.42	$2.63	$2.87	$3.09	$3.32	$3.54	$3.77	$3.99
70-74%	$1.83	$2.05	$2.26	$2.45	$2 68	$2.87	$3 10	$3.30	$3.52	$3.73
65-69%	$1.70	$1.91	$2.10	$2.29	$2.50	$2.69	$2.89	$3.08	$3.28	$3.53
60-64%	$1.58	$1.77	$1.94	$2.12	$2.31	$2.49	$2.67	$2.85	$3.03	$3.21
55-59%	$1.45	$1.63	$2.00	$1.95	$2.13	$2.29	$2 45	$2.62	$2.79	$2.95
50-54%	$1.32	$1.48	$1.63	$1.78	$1.94	$2.09	$2.25	$2.39	$2.57	$2.69
45-49%	$1.19	$1.34	$1.47	$1.61	$1.75	$1.89	$2.02	$2.16	$2.30	$2.43
40-44%	$1.07	$1.20	$1.32	$1.44	$1.56	$1.69	$1.81	$1.93	$1.95	$2.17
35-39%	$0.94	$1.06	$1.16	$1.27	$1.38	$1.45	$1.59	$1.70	$1.81	$1.92
30-34%	$0.85	$0.91	$1.00	$1.09	$1.19	$1.28	$1.38	$1.49	$1.57	$1.66
25-29%	$0.90	$0.77	$0.85	$0.92	$1.01	$1.08	$1.16	$1.24	$1.32	$1.40
20-24%	$0.56	$0.63	$0.69	$0.74	$0.82	$0.88	$0 95	$1.01	$1.08	$1.14
15-19%	$0.44	$0.49	$0.53	$0.58	$0.64	$0.68	$0 73	$0.78	$0.83	$0.88
10-14%	$0.31	$0.34	$0.38	$0 41	$0 45	$0.48	$0.52	$0.55	$0.59	$0.62
05-09%	$0 18	$0.20	$0.22	$0.24	$0 26	$0 28	$0 27	$0 32	$0 34	$0 36

In addition, the City has established a separate class "K" for commercial/industrial users with greater than 1,000 mg/l of TSS and computes rates individually for those users. The City's existing user classification for the most part complies with the revenue program requirements.

With respect to large users the revenue program guidelines, Section 1-3, state that,

"Large commercial users discharging more than 25,000 gallons per day must have their costs allocated individually."

While the City currently assigns costs individually for commercial/industrial users with greater than 1,000 mg/l of TSS, it does not assign costs individually for users that discharge greater than 25,000 gpd of flows. In addition, the incorporation of COD necessitates changes to the existing user matrix. Therefore, Black & Veatch performed a review of the user classifications and proposed alternatives to classify commercial/industrial users.

User Classification Options: No changes were required for the residential classifications. To comply with the requirements, commercial/industrial users with greater than 25,000 gpd of discharge were first identified as Large Users. Different options were then examined for redefining commercial/industrial users discharging less than or equal to 25,000 gpd of wastewater flows.

The existing user class matrix method with 200 discrete classes enables the City to efficiently accommodate high levels of flow and strength variability that usually exists among the different types of business users. Therefore, most of the options examined are centered on the matrix method. The four options considered for commercial/industrial users that discharge less than or equal to 25,000 gpd of flows were:

- *Option 1:* Retain the existing commercial/industrial 20X10 user class matrix but convert the 10 TSS classes to 10 classes of cost weighted TSS/COD index.
- *Option 2:* Modify the existing commercial/industrial matrix to a 10X5 matrix of 50 discrete classes.
- *Option 3:* Eliminate the Matrix method and instead define 7-9 TSS/COD strength based commercial/industrial user groups.
- *Option 4:* Define a 10X11 matrix of 110 classes based on TSS and COD increments.

Option 1: This option retains the 20X10 user class matrix with 200 discrete classes. The matrix includes the existing 20 return to sewer classes but instead of the 10 TSS strength based classes, the matrix includes 10 TSS/COD based classes in the form of a cost-weighted TSS/COD index. This option while retaining the familiar 20X10 matrix also accommodates the inclusion of the COD parameter in classifying users.

Option 2: This option involves developing a modified user class matrix with fewer discrete classes. Instead of the 200 discrete classes, the modified matrix would be a 10X5 matrix with only 50 classes. The matrix would be based on 10 return to sewer classes and five TSS/COD based classes. As in Option 1, the TSS/COD classes will be in the form of a cost-weighted index. This option has fewer classes than Option 1 since the TSS/COD index increases in larger increments and the return to sewer percentage decreases in larger decrements than that proposed in Option 1.

Option 3: This option eliminates the use of the matrix method and instead defines seven to nine broad TSS/COD strength based commercial user groups. In this option, the return to sewer variable would be applied to each user's water usage, directly at the time of billing.

Option 4: This option defines user classes based on the existing matrix method. However, instead of the return to sewer/TSS matrix, this option substitutes a strength-based 10X11 TSS/COD matrix with 110 discrete classes. The 10 TSS strength classes would increase in 100 mg/l increments and the 11 COD strength classes would increase in 200 mg/l increments. As in option 3, the user's return to sewer percentage would be directly applied to the user's water usage during billing.

The stakeholders' group decided to recommend implementation of Option 4 since the City' users are familiar with the matrix format and this option provides greater equity than the other options examined.

Cost Allocation

The approach used in allocating costs to the wastewater parameters is fundamental to a fair and equitable apportioning of costs among the City's various user classes. The two specific cost allocation issues that were examined during this Study include:

1. Selection of a cost allocation method to allocate the City's cost of service to the wastewater parameters.
2. Application of the selected cost-allocation method in actually allocating costs.

Selection of Cost Allocation Method

Utilities use different cost allocation methods taking into consideration several factors including local policy, characteristics of the wastewater flows received, type of wastewater system (regional system versus single municipal system), type of treatment facilities, geographic and engineering operational considerations and regulatory requirements.

The City operates a regional system that provides retail service to the City's users and wholesale service to the PAs. In addition, as a recipient of federal grants and state loans the City is obligated to comply with CWG and SRF program requirements.

With respect to establishing a system of user charges, the SWRCB guidelines state that:

> "User charges must recover the cost of operation and maintenance (including replacement) from all users based on their proportionate contribution to the total wastewater loadings from all users. The State recommends that user rates designed to recover all other costs be proportional to the cost of the service rendered."

Further, the Clean Water Act of 1972, P.L. 92-500 as amended, (Act) states, in part:

> "The Administrator shall not approve any grant for any treatment works under section 201(g)(1) after March 1, 1973, unless he shall first have determined that the applicant (A) has adopted or will adopt a system of charges to assure that each recipient of waste treatment services within the applicant's jurisdiction, as determined by the Administrator, will pay its proportionate share (except as otherwise provided in this paragraph) of the costs of operation and maintenance..."

To ensure compliance with SWRCB revenue program requirements, the allocation of costs to the different parameters has to be based on the following three underlying principles:

- The wastewater parameters used in allocating cost responsibility to the different user classes must include flow, TSS and COD.
- Cost allocations to the flow, TSS and COD parameters need to be done using a "system-wide" approach. In order to recognize the shared configuration of the City's wastewater system that includes a complex exchange of solids, centrates and effluents and the sharing of a common outfall, the facilities need to be considered not in isolation but as components of an integrated "regional system".
- A proportional cost allocation method needs to be used to allocate costs between the different parameters and the different user classes.

In addition to the above, factors that were considered in the selection of a cost allocation method include:

- The revenue program developed for the City's wholesale service to the PAs. The City developed a revenue program, which is based on a system-wide approach with a functional-design based allocation of costs to the wastewater parameters of flow, TSS and COD. This method, which was approved by the SWRCB, is outlined in the Regional Wastewater Disposal Agreements between the City and the PAs. Changes to the cost allocation method for the City's own retail users have to be reviewed in the context of its potential impact on the City's existing contractual obligations to the PAs.
- Fair and equitable allocation of costs among user classes.

Cost Allocation Options: Black & Veatch outlined three allocation methods taking into consideration the factors discussed above. The three methods reviewed include:

- ***Option 1: Functional Method.*** In this method costs are allocated to wastewater parameters based on the functions of the various steps in the treatment process. This allocation is based on the premise that operational function drives costs. This method usually results in higher cost allocations to strength parameters.
- ***Option 2: Design Method.*** In this method costs are allocated to wastewater parameters based on design criteria used to size individual facilities or processes. This allocation is based on the premise that design considerations drive costs. This method results in higher cost allocation to flow.
- ***Option 3: Functional-Design Method.*** In this method costs are allocated to wastewater parameters based on the functional, design and operational performance criteria of the different processes. This is the method that is currently used by the City and generally provides a balance between the other two methods.

It was decided to retain the functional-design method as the appropriate method for allocating the City's cost of service. This method has already been approved by the City and the PAs and provides a balanced and proportionate approach to allocating costs.

Application of the Selected Cost Allocation Method

Black & Veatch reviewed MWWD's application of the functional-design method in allocating costs to the wastewater parameters. In addition, Black & Veatch also reviewed the allocation methodology described in a paper presented in the Water Pollution Control Federation in 1986 by Dr. C.W. Corssmit. While the methodology prescribed in the paper titled, "Wastewater Utility Unit Process Cost Parameter Allocations: Advancing Towards A Scientific Method", is not universally accepted as a definitive industry standard, Black & Veatch reviewed Corssmit's allocation methodology at the request of the stakeholder group.

Review Findings: MWWD had conducted an extensive cost allocation study in 1998 to determine the Metro O&M and capital allocation percentages for the parameters of flow, TSS and COD. MWWD conducted the allocation study using the three alternative allocation methods: Functional, Design and Functional-Design. MWWD ultimately adopted the cost allocation percentages derived using the Functional-Design method after the SWRCB and the PAs approved it. The allocations are currently used in determining the City and PAs' share of Metro O&M and capital costs.

Black & Veatch concurred with the functional-design allocation method adopted by MWWD for the following reasons:

- The method is based on the *proportional* cost allocation method, as stated in the Clean Water Act.

- Consistent with the definition of functional-design method, the allocation takes into consideration the operational performance characteristics of the facilities and the regulatory requirements. For example, PLWTP, which is an advanced primary treatment plant, removes nearly 85 to 87 percent of the influent TSS and nearly 60 percent of the influent BOD. PLWTP needs to comply with the NPDES requirements established by the EPA. The permit requires PLWTP to achieve 80 percent removal of TSS and 58 percent removal of BOD. While PLWTP's primary function is to mainly remove TSS, it also incidentally removes BOD during the process. To meet the NPDES 58 percent BOD removal requirement, PLWTP has to actually achieve 85 to 87 percent TSS removal since BOD removal in an advanced primary facility is essentially accomplished through TSS removal.

Taking into consideration PLWTP's BOD removal requirement and the operational performance required to meet the NPDES requirements, the MWWD functional-design method allocates PLWTP strength costs between TSS and BOD/COD in proportion to the relative removal of these two strength constituents of the wastewater.

- The method of allocating strength costs between TSS and BOD/COD proportionate to relative removal is consistently applied to all other facilities in the system, in recognition of the fact that the City's various facilities operate as an integrated regional system.

- The allocation process appropriately classifies wastewater system costs into various component costs including direct and indirect costs and allocates the indirect costs to the parameters in proportion to the allocation of direct costs.

Black & Veatch reviewed the methodology proposed in Corssmit's paper and concluded that the methodology is not applicable to the City's regional system for the following reasons:

- The functional-design based allocation method proposed for advanced primary treatment facilities in Corssmit's paper does not allocate any costs to BOD removal, and instead allocates all costs between flow and TSS. This approach is not suitable to PLWTP, which has a unique regulatory obligation to remove BOD.

- Corssmit's method does not take into account the removal of BOD in advanced primary plants. The use of Corssmit's cost allocation approach to PLWTP would result in excessive allocation of PLWTP costs to the TSS parameter and consequently adversely impact users that contribute high amounts of TSS and benefit users that contribute high amounts of BOD/COD. The method would lead to a disproportionate allocation of PLWTP costs between TSS and COD.

MWWD's cost allocation approach develops defensible unit costs of flow, TSS and COD and meets regulatory requirements. However, a few minor changes were made to fine-tune MWWD's method and the revised allocation percentages were used for the City's retail service area cost allocations. The revisions relate to the allocation of Metro Biosolids Center annual O&M costs and the allocations of a few sewer trunk line CIP costs. The revisions are discussed in Section 7 of this report.

Rate Structure Design

The classification of the users, the allocation of costs and the design of the rate structure, all have an impact on user rates. The factors considered in the design of rate structure options include:

- Inter-class revenue neutrality: The rate structure for each user class would result in each user class paying its allocated share of costs. In other words, no user class would pay more or less than its fair share.

- The rate structure would include a fixed charge and a variable charge component.

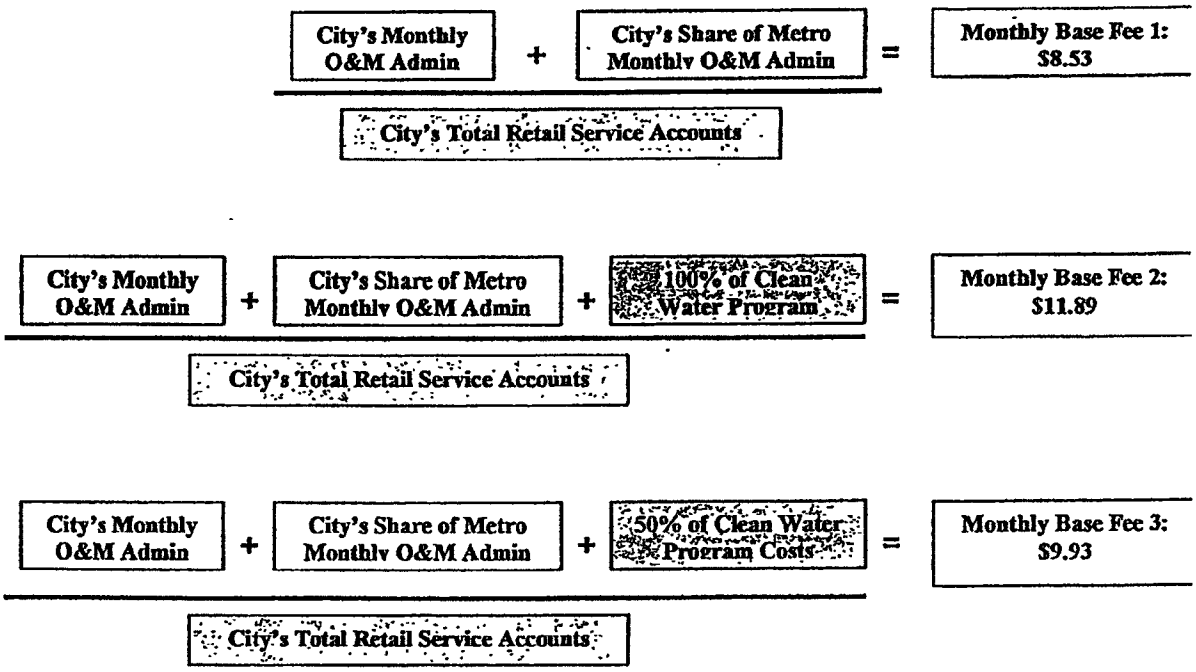
- The fixed charge in the form of a base fee would include only those administrative and general costs that are common to all and would be the same for each account.

The following issues were examined as part of the evaluation of the rate structure alternatives:

- Level of Base Fee
- Level of SFR Usage Cap
- TSS/COD loadings computation for the different classes in the commercial/industrial matrix

Level of Base Fee: Three different levels of Base Fee were evaluated: monthly base fees of $8.53, $11.89 and $9.93. Figure 6-1 shows the costs included in the computation of the different Base Fee levels. A monthly Base Fee of $9.93 was agreed upon by the stakeholders' group.

FIGURE 6-2 COMPUTATION OF DIFFERENT LEVELS OF BASE FEES



Level of SFR Usage Cap: The City currently has a usage cap of 10 hcf for the SFR class and therefore water usage greater than 10 hcf is not considered for sewer billing. However, the mass balance analysis indicates a need for a higher usage cap level. While the increase or decrease of usage cap levels does not impact any other user class, it does impact individual users within the SFR user class. Typically, lower usage caps benefit high volume water users and higher usage caps benefit low volume water users.

It was necessary to increase the level of SFR usage cap to achieve a reliable mass balance. Three different alternative SFR usage cap levels were proposed: Usage Cap levels at 12, 14 and 16 hcf of water usage. An incremental increase to 12 hcf would be appropriate, however, the stakeholders' group consensus was to increase the usage cap to 14 hcf.

At the 10 hcf cap, 76 percent of winter water usage is captured and at 12, 14 and 16 hcf levels, the capture rate is 82, 87 and 90 percent, respectively.

TSS/COD Loadings Computation: In the proposed commercial/industrial rate matrix, each TSS and COD class is defined by a range of strength, for example, 101 – 200 mg/l of TSS or 201 – 400 mg/l of COD. To compute the actual rate per hcf of wastewater for each class in the matrix, the following two methods could be used:

- Mid-point of the strength range
- The actual strength computed based on the available user data for all the users that belong to a particular class in the matrix

There are both pros and cons to both of the methods mentioned above. The benefit of using the mid-point of the strength range is that it can be consistently applied to all the strength ranges in the matrix. However, the mid-point strength for any given range also has the potential of being either higher or lower than the actual average strength of all the users in a given class, which could lead to higher or lower user revenues than projected.

The benefit of using actual strength computed based on available user data is that it is likely to be a more accurate representation of user class strength characteristics and revenue collection. However, the disadvantage is that in reality user data may not be available for some strength ranges if currently no users belong to those strength ranges. In such a situation, mid-point of the strength range would have to be used to compute the wastewater rate. In addition, rates would have to be recomputed when users and/or flows or strengths for any given range changes.

The stakeholders' group decided to use the mid-point of the strength range in computing the rates since it provides for a more consistent approach, which could be used to derive the rates for all the classes in the matrix, irrespective of user data availability.

STAKEHOLDER INPUT

The study process included the participation of a stakeholders' group with members representing a broad range of interests, both residential and businesses. The goal of stakeholder participation was to ensure public understanding of the complexities of the cost of service and rate design process and to create an opportunity for the group to examine rate structure alternatives, to voice concerns and to provide recommendations. While detailed discussions on stakeholder participation are presented in an independent report titled, "Sewer Cost of Service: stakeholders' group Final Report", the group's recommendations are outlined here.

User Classification: Black & Veatch presented the four different options available for classifying commercial/industrial users that discharge less than 25,000 gpd. The group reviewed the alternatives presented and preferred the strength based matrix classification. Therefore, the group recommended Option 4, which involves establishing a 10X11 TSS/COD user class matrix. As mentioned in Section 4 of this report, in the proposed classification, commercial/industrial users that discharge less than 25,000 gpd are referred to as Matrix Users.

Cost Allocation: The group reviewed the three alternative cost allocation methods and accepted the use of the functional-design method to allocate costs to flow, TSS and COD. However, a subgroup of members disagreed with the way the functional-design method was applied in allocating costs, even though in concept, they accepted the functional-design method. Instead of the City's method of proportionate allocation of costs to the parameters, the subgroup preferred an alternative incremental allocation based method. The subgroup's alternative method, which is referred as the "Straight TSS Method", is included in Appendix B of the Sewer Cost of Service Stakeholders' Group Final Report.

Black & Veatch reviewed the "Straight TSS Method" method proposed by the stakeholder subgroup

and found the method unacceptable due to the following reasons:

- The method uses an incremental approach rather than proportional cost sharing in allocating PLWTP and MBC costs, leading to a disproportionately higher allocation of costs to the TSS than to the COD parameter.

- The method advocates an incremental cost allocation approach to PLWTP primary costs, but proposes proportional cost allocation for primary and secondary costs at NCWRP. This approach results in internal inconsistencies in the methods used across the different processes and facilities of an integrated system.

In an effort to obtain the SWRCB's opinion on the cost allocation issue, Black & Veatch derived allocation percentages for flow, TSS and COD using three different methods and sent the analysis to the SWRCB. The three alternative cost allocation methods sent were:

- City's functional-design allocation based on MWWD's proportionate removal of TSS and COD.
- stakeholder subgroup's allocation based on the "Straight TSS Method".
- City's allocation based on the "Modified Straight TSS Method", which allocated costs consistently at PLWTP and NCWRP.

The cost allocation package sent to the SWRCB is included in Appendix 6-1. The SWRCB's response essentially states that the "Straight TSS Method" and the "Modified Straight TSS Method" do not comply with the CWG program regulations and SRF program guidelines since these methods do not allocate costs proportionately between TSS and COD. The allocation method used for the City needs to be consistently applied to the regional system and the PA's. This would necessitate a change from the current method and possibly extensive negotiations with the PA's to obtain their approval. The SWRCB's response is included in Appendix 6-2.

Rate Structure Design: The group provided input on all three issues examined as part of rate structure design.

- ***Base Fee:*** With respect to the Base Fee alternatives presented, the group recommended setting the monthly base fee under $10 to ensure that low income/low volume users are not burdened with a high fixed monthly charge. Therefore the group selected the $9.93 monthly base fee option.

- ***SFR Usage Cap:*** As regards the SFR usage cap level, the group preferred that usage cap be set at 16 hcf of water usage. However, taking into consideration the impact of the 16 hcf usage cap level on both the City's high water users as well as the large low-income families, the group recommended that SFR usage cap be set at the 14 hcf level in FY 2002 and be increased to the ultimate 16 hcf over a period of two years.

- ***TSS/COD Loadings Computation:*** While most of the individual members did not have any specific preference with respect to the method used in the computation of rates for each class in the matrix, the group as a whole recommended that loadings be computed using the mid-point strength of the range.

The stakeholders' input in conjunction with input from City staff provided the direction for the

subsequent phases of the Study, which include the allocation of costs and the design of rate structures. The allocation of costs is discussed in Section 7 and the proposed rate structures are discussed in Section 8.

Section 7
Cost of Service

The determination of the City's user class flows and loadings discussed in Section 4 of this report, and the revenue requirements reviewed and finalized through the operating and capital cash flow analysis discussed in Section 5 of the report, provide the basis for performing the cost of service analysis. This section of the report discusses the allocation of operating and capital costs to the Flow, TSS and COD parameters, the determination of unit rates, and the estimation of user class cost responsibility.

COST OF SERVICE ANALYSIS

The total revenue requirements net of revenue credits from miscellaneous sources, is by definition, the net cost of providing service. This cost of service is then used as the basis to develop unit rates for the wastewater parameters and to allocate costs to the various user classes in proportion to the wastewater services rendered. The concept of proportionate allocation to user classes implies that allocations should take into consideration the quantity of wastewater a user contributes and the strength of wastewater.

In this Study, wastewater rates need to be calculated for FY 2002, and accordingly FY 2002 revenue requirements are used in the cost allocation process.

Cost of Service to be Allocated

The annual revenue requirements or costs of service to be recovered from wastewater charges include operation and maintenance expenses, costs associated with annual renewal and replacements, and other capital related costs. O&M expenses include costs directly related to the collection, treatment, and disposal of wastewater, and maintenance of system facilities. Renewals and replacements represent the annual recurring capital outlay for minor system improvements and purchase of equipment.

The total FY 2002 cost of service to be recovered from the City's retail users, as shown on line 15 in Table 7-1, is estimated at nearly $194 million, of which $130 million is operating costs and the remaining $64 million is capital costs. The cost of service analysis is based upon the premise of generating annual revenues adequate to meet the estimated annual revenue requirements. As part of the cost of service analysis, revenues from other non-City user sources such as revenues from shipboard waste and PAs are deducted from the appropriate cost elements. Additional deductions are made to reflect the use of rate stabilization fund and operating interest income during FY 2002. Adjustments are also made to account for cash balances and annualization of rate increases.

To allocate the cost of service among the different user classes in proportion to their flows and strength contribution, costs first need to be allocated to selected wastewater parameters. The following subsection describes the allocation of the operating and capital cost of service amounts to the selected parameters of the wastewater system.

Section 8
Rate Design

The revenue requirements and cost of service analysis described in the preceding sections of this report provide a basis for the design of wastewater rates. Rate design involves the development of rate schedules for each user class so as to recover the annual cost of service determined for each user class. In this Study, the focus of rate design is on the development of rate schedules for each of the City's retail service user classes, which was accomplished with input from the stakeholders' group. This section of the report discusses proposed wastewater rate structures, presents a schedule of rates for the City's user classes, and analyzes the impact on user classes due to the proposed changes in the user classifications, cost allocation and rate design.

RATE STRUCTURE

Rate structures need to be fair and equitable to ensure that every user class pays its fair share of costs. In addition, rate structures should be easy to understand, simple to administer, and comply with regulatory requirements. A review of the existing rate structures provides insights into the equitability of the current methodology and the changes, if any, that need to be made. The existing rate structure was discussed in detail in Section 3. The proposed rate structures are discussed in the following subsections.

Proposed Rate Structure

The proposed rate structures for all of the City's user classes will include both a fixed charge in the form of a base fee and a variable charge in the form of a usage rate. In other words, the annual revenues required from each user class presented in Table 7-7 would be recovered through a combination of a fixed monthly base fee and variable usage rate. The base fee and the proposed usage rate for the various user classes are discussed in detail.

Base Fee

A base fee is a cost recovery mechanism that is included in the rate structure to recover certain fixed and indirect costs. They provide a stable source of revenues independent of usage. We recommend that the City continue its existing practice of applying a monthly base fee to all its users. However, we recommend that the City modify its practice of applying different base fees to different user classes. Instead, we propose that the City apply a uniform monthly base fee to all its users.

Wastewater utilities incur direct costs that vary with changes in the quality and volume of flows received and indirect costs that typically do not change with flow characteristics. Direct costs are variable expenditures that include costs associated with collection, conveyance, treatment, and disposal operations. Indirect costs are fixed expenditures that relate to operational support activities including accounting, sewer billing, customer service, and administrative and technical support.

The indirect costs are essentially common-to-all costs that are independent of user class characteristics. A base fee provides a mechanism for recovering these common-to-all costs and ensures a stable source of user revenues for the utility. To determine the monthly base fee, the City's fixed indirect costs need to be identified. The City's FY 2002 indirect costs that are used to determine the monthly base fee are

estimated based on the Muni indirect O&M costs and the City's share of Metro indirect O&M costs. The City's indirect costs for FY 2002 are estimated at $32 million. Table 8-1 presents details of the costs included in the indirect costs.

TABLE 8-1 ESTIMATION OF INDIRECT COSTS USED TO DETERMINE BASE FEE

Description	Amount FY 2002 $
Muni Indirect O&M (Management, Administration & Support) - Inflated	**$1,260,000**
Metro Indirect O&M (Management, Administration & Support): City's Share	
Metro Admin	17,101,000
Central Support Facility	4,002,000
Technical Services Admin	2,426,000
Equipment Purchases & Income Credits	(1,092,000)
Other City Depts. Applicable to Sewer	3,396,000
General Accounting	243,000
Clean Water Program Admin	4,496,000
City's Share of Metro Indirect O&M (Inflated)	**$30,571,000**
Total Estimated City Indirect Costs allocated to Base Fee ($1,260,000 + $30,571,000)	**$ 31,831,000**

As mentioned in the discussion of issues in Section 6, the stakeholder group preferred to set the monthly base fee at under $10.00 and hence only 50 percent of Metro's Clean Water Program Administration costs were used in estimating the City's share of Metro indirect costs.

Since the indirect costs are common to all users, we propose that these costs be shared equally by all the City's user accounts. The monthly base fee is obtained by dividing the FY 2002 indirect costs by the total number of annual City's user accounts. The estimated monthly base fee of $9.93 for FY 2002 is shown in Table 8-2.

Usage Rate

The usage rate is the rate determined for each user class to recover the City's variable direct costs. The annual estimated FY 2002 revenues required, less annual base fee revenues, are the revenues that need to be recovered through a usage rate. Table 8-3 shows the Base Fee revenues and the usage rate revenues for FY 2002.

the user's water consumption. For example, for a MFR user with monthly water usage of 20 hcf of water, the usage charge is $55.40. With the inclusion of the $9.93 monthly base fee, the total monthly wastewater charge would be $65.33. For a MFR user with a return rate different than 95 percent return to sewer, the usage rate would be

($2.77/0.95) x Return factor x Water Usage

For an MFR user with 20 units of water use per month and a return factor of 90 percent the usage charge would be

(2.77/0.95) x 0.90 x 20 = $52.48

With the inclusion of the $9.93 monthly base fee, the total monthly wastewater charge would be $62.41.

Commercial/Industrial Usage Rate and Computation of Monthly Wastewater Charge

As discussed in Section 4, the proposed commercial/industrial user classification includes the Matrix User classes and the Large Users. The development of wastewater usage rates for the commercial/industrial users involves a two step process. The unit costs of flow, TSS and COD for FY 2002 are first determined for the commercial/industrial user class as a whole and then based on those unit costs wastewater usage rates are determined for the Matrix User classes and the Large Users.

Determination of Commercial/Industrial User Loadings: The annual TSS and COD loadings usually are determined based on the users' annual flows, and assigned or measured TSS/COD strengths. In the case of Matrix Users, currently, most elements (strength ranges) in the matrix have users for which annual flows and assigned strength data are available. For these users annual TSS/COD loadings can be computed based on the *actual assigned strength* and estimated annual flows. However, there are some elements in the matrix that do not have any users. Consequently, in the absence of flows and actual assigned strengths, loadings for these elements need to be computed based on the *mid-point strength* of the range. In order to use a consistent computation approach for all classes in the matrix, in this study, the annual TSS and COD loadings for the Matrix Users are computed by applying the mid-point strength of each of the 110 matrix elements to its respective annual flows.

For Large Users, the annual TSS/COD loadings are computed based on their actual assigned or measured strengths and estimated annual flows. Figure 8-1, presents a graphical representation of the estimation of commercial/industrial user annual TSS and COD loadings.

FIGURE 8-1 COMPUTATION OF COMMERCIAL/INDUSTRIAL ANNUAL TSS AND COD LOADINGS

Determination of Commercial/Industrial User Unit Costs: The unit costs for flow, TSS and COD are determined based on the commercial/industrial annual flows, and TSS/COD loadings, and estimated FY 2002 usage revenues required. The estimated FY 2002 annual usage revenue required is first allocated to flow, TSS and COD parameters. The cost allocated to each parameter is then divided by annual flows and loadings to derive the unit costs. Table 8-7 shows the development of commercial/industrial unit costs for the three parameters.

TABLE 8-7 DEVELOPMENT OF COMMERCIAL/INDUSTRIAL UNIT COSTS OF FLOW, TSS AND COD

User Class Description	Total Revenues (COS) $	Base Fee-3 Revenues $	Usage Revenues $	Flow Revenues $	TSS Revenues $	COD Revenues $	Unit Costs Flow $	Unit Costs TSS $	Unit Costs COD $
Com/Ind Combined Unit Rate	60,071,680	1,879,429	58,192,251	34,118,117	10,311,667	13,762,467	$2.0756	$0.3594	$0.1324

Determination of Sewer Usage Rates and Monthly Charges for Matrix Users: Based on the unit costs determined for the commercial/industrial users, wastewater rates are computed for the Matrix Users and the Large Users. In the case of Matrix Users, the rates are computed for each TSS/COD strength range in the matrix based on the mid-point strength of the range. Table 8-8 shows the development of rates for the classes in the matrix assuming 100 percent return to sewer.

TABLE 8-8 COMMERCIAL/INDUSTRIAL MATRIX USERS' WASTEWATER RATES (FY 2002)

(mg/l)		TSS 50	TSS 150	TSS 250	TSS 350	TSS 450	TSS 550	TSS 650	TSS 750	TSS 850	TSS 950
COD	COD	A	B	C	D	E	F	G	H	I	J
100	AA	$2.270	$2.493	$2.715	$2.938	$3.161	$3.384	$3.607	$3.830	$4.053	$4.275
300	BB	$2.434	$2.657	$2.880	$3.102	$3.325	$3.548	$3.771	$3.994	$4.217	$4.440
500	CC	$2.598	$2.821	$3.044	$3.267	$3.490	$3.712	$3.935	$4.158	$4.381	$4.604
700	DD	$2.762	$2.985	$3.208	$3.431	$3.654	$3.877	$4.100	$4.322	$4.545	$4.768
900	EE	$2.927	$3.149	$3.372	$3.595	$3.818	$4.041	$4.264	$4.487	$4.709	$4.932
1100	FF	$3.091	$3.314	$3.537	$3.759	$3.982	$4.205	$4.428	$4.651	$4.874	$5.097
1300	GG	$3.255	$3.478	$3.701	$3.924	$4.147	$4.369	$4.592	$4.815	$5.038	$5.261
1500	HH	$3.419	$3.642	$3.865	$4.088	$4.311	$4.534	$4.756	$4.979	$5.202	$5.425
1700	II	$3.584	$3.806	$4.029	$4.252	$4.475	$4.698	$4.921	$5.144	$5.366	$5.589
1900	JJ	$3.748	$3.971	$4.194	$4.416	$4.639	$4.862	$5.085	$5.308	$5.531	$5.754
2100	KK	$3.912	$4.135	$4.358	$4.581	$4.803	$5.026	$5.249	$5.472	$5.695	$5.918

In computing monthly wastewater charges, the user's wastewater flows are first determined by applying the user's assigned return to sewer percentage to monthly water usage. The rate specific to the user's TSS and COD strength is then selected from the matrix and applied directly to the computed monthly wastewater flows. Table 8-9 shows a sample monthly sewer charge calculation for a user with a

monthly water usage of 25 hcf, an assigned return to sewer of 80%, TSS of 380 mg/l and a COD of 620.

TABLE 8-9 SAMPLE CALCULATION OF MONTHLY SEWER CHARGE

Bi-Monthly Water Usage (hcf)	25
Estimated Bi-Monthly Wastewater Flows (hcf) (1)	20
Sewer Usage Rate ($ per hcf) (2)	$3.431
Bi-Monthly Sewer Usage Charge (3)	$68.62
Bi-Monthly Base Fee (4)	$9.93
Total Bi-Monthly Sewer Charges (5)	$78.55

NOTE:
(1) Based on an assigned 80% return to sewer.
(2) Based on an assigned TSS of 380 mg/l and a COD of 620 mg/l.
(3) Estimated Bi-Monthly flows times $3.431.
(4) Bi-Monthly sewer usage charge plus monthly base fee.

Determination of Sewer Usage Rates and Monthly Charges for Large Users: For the Large Users, sewer usage rate is computed individually for each user based on the commercial/industrial unit costs shown in Table 8-7. The annual wastewater rate computed individually for each large user is included in Appendix 8-1. A sample monthly wastewater charge calculation for a large user with TSS strength of 640 mg/l and COD strength of 2,000 mg/l is shown in Table 8-10.

TABLE 8-10 SAMPLE MONTHLY CHARGE CALCULATION FOR LARGE USER

Monthly Flow (hcf)	TSS (mg/l)	TSS (lbs)	COD (mg/l)	COD (lbs)	Monthly Usage Charge (1) $	Monthly Base Fee $	Monthly Sewer Charge (2) $
1,078	640	4,249	2,000	13,279	$5,545.52	$9.93	$5,555.45

NOTE
(1) Monthly Usage Charge computed based on the commercial/industrial unit cost shown in Table 8-7.
(2) Total Monthly Sewer Charge is Monthly Usage Charge plus Monthly Base Fee.

ADEQUACY OF PROPOSED RATES AND CHARGES

The rates as proposed in this report should generate adequate wastewater user revenues to meet projected requirements through FY 2003. We recommend that the City conduct a financial review during FY 2003 to review program changes and adjustments, and the adequacy of expected revenues for FY 2004 and subsequent years.

IMPACT ANALYSIS

Black & Veatch performed an impact analysis to evaluate the impact of the proposed changes to user classification, the changes to the SFR usage cap level, the introduction of the COD parameter and the changes in rate design. The impacts of each of these changes among user classes and within user classes are discussed below.

User Classification

The proposed changes to user classification relate primarily to commercial/industrial user classes and hence there is no impact on the SFR and MFR residential user classes due to user classification changes. Matrix Users may see an increase or decrease in bi-monthly charges due to the fact that users in the proposed classification are categorized based on TSS/COD instead of TSS/Return to Sewer. This leads to reconfiguration of users within the matrix. For instance two users who belong to the same TSS/Return to Sewer class in the existing user class matrix may, in the proposed classification scheme, belong to two different classes due to the differences in their COD strengths.

In the proposed classification, Large Users have been categorized into a separate class as required by the SWRCB revenue program. These users may see an increase or decrease in their bi-monthly wastewater charges depending on whether they are at the low or high end of the TSS/COD range. The change is due to the fact that charges are to be computed on their actual TSS/COD strengths instead of the existing method where charges are computed based on the user class rate matrix wastewater rates.

Usage Cap

The usage cap applies only to the SFR user class and hence the proposed change to the usage cap level would not impact the other user classes. However, it would impact the users within the SFR class. The increase in the level of usage cap from 10 to 14 hcf results in the lowering of per-unit usage costs, which would benefit all SFR users with water usage less than 10 hcf per month. Since usage up to 14 hcf is to be billed under the proposed method instead of the existing 10 hcf, bills could be higher for users with high water usage.

COD Parameter

The introduction of the COD parameter will result in revenue redistribution between residential and commercial/industrial user classes and will also impact certain user classes within the commercial/industrial category. Many commercial/industrial user classes have high concentrations of COD. Residential TSS (265 mg/l) is comparable to average system TSS (269 mg/l). However, Residential COD (450 mg/l) is lower than system COD (610 mg/l). Therefore, introduction of the COD parameter results in a shift in cost burden from the residential to the commercial/industrial user classes.

Within the commercial/industrial category, there is wide variability in TSS and COD strengths and the introduction of COD may result in sewer charge increases for user classes with high COD and sewer charge decreases for user classes with low COD.

Rate Design

The proposed fee structure with uniform base fee for all users will result in sewer charge changes for many user classes. The existing 2001 monthly base fee for MFR and commercial/industrial users is just $0.51, and hence the proposed uniform monthly base fee of $9.93 would impact all non-SFR user classes. However, the recovery of a larger portion of the revenues required from a user class through the base fee will lead to the lowering of user class unit costs for flow, TSS, and COD parameters. The lowering of unit costs will benefit higher volume dischargers in each user class.

The overall impact on any given user or user class depends on one or more of the factors discussed above. The combination of changes proposed, including user reclassification, introduction of COD and the establishment of uniform base fees, however, results in a fair and equitable cost allocation among the various user classes.

Table 8-11 shows monthly SFR wastewater charges under the proposed rates and existing 2001 rates at different levels of water usage. Under the proposed rate structure, after March 2002, all SFR users will benefit as shown in Table 8-12. Table 8-12 also shows the impact on a sample of commercial/industrial user types and on SFR and MFR user classes based on the proposed method and existing method using March 2002 rates. Most MFR customers will benefit under the proposed rates. Impacts on commercial customers are mixed depending on their flow and strength.

TABLE 8-11 COMPARISON OF PROPOSED AND EXISTING 2002 RATE IMPACT ON SFR USER CLASS

Monthly Usage (HCF)	Proposed Method Monthly Charge (FY 2002) $	Existing Method Monthly Charge (FY 2002) $	Monthly Charge Difference $	Percent Charge Difference %
1	12.15	12.71	-0.56	-4.4%
2	14.37	15.99	-1.62	-10.1%
3	16.59	19.27	-2.68	-13.9%
4	18.81	22.55	-3.74	-16.6%
5	21.03	25.83	-4.80	-18.6%
6	23.25	29.11	-5.86	-20.1%
7	25.47	32.39	-6.92	-21.4%
8	27.69	35.67	-7.98	-22.4%
9	29.91	38.95	-9.04	-23.2%
10	32.13	42.23	-10.10	-23.9%
11	34.35	42.23	-7.88	-18.7%
12	36.57	42.23	-5.66	-13.4%
13	38.79	42.23	-3.44	-8.2%
14	41.01	42.23	-1.22	-2.9%
15	41.01	42.23	-1.22	-2.9%
16	41.01	42.23	-1.22	-2.9%

NOTE
Proposed and Existing Monthly Charges include monthly base fee and usage fee. The proposed charges are based on a usage cap of 14 hcf and a 7.5% revenue requirement adjustment.
The existing monthly charge is based on 10 hcf usage cap.

DRAFT

APPENDIX 6-1
SWRCB COST ALLOCATION PACKAGE

DRAFT

May 22, 2001

Mr. Ron Blair
Revenue Program Specialist
State Water Resources Control Board
Division of Clean Water Programs
P.O. Box 944212
Sacramento, CA 94244-2120

Subject: Wastewater Revenue Program Cost Allocation Methodology

Dear Mr. Blair:

As you're aware, we're currently conducting a cost of service/rate design study for retail sewer service within the City of San Diego. The study includes stakeholder participation and input. In allocating costs of the various wastewater treatment processes to strength parameters, the City is using the currently approved proportional cost allocation method that is based on the functional-design approach. As I described to you in our phone conversation last Wednesday, some members of the stakeholder group have proposed an alternative, hybrid approach, which they refer to as the "Straight TSS Method (STSS)". We are submitting these two approaches, plus a third, internally consistent, incremental allocation approach to you for review and comment as to their acceptability before completion of the study and adoption of rates by the City Council.

We have briefly described the City's current allocation method and the hybrid STSS Method below. As I explained to you last Wednesday, we are concerned that the latter method is internally inconsistent in how it allocates costs at Pt Loma and at North City Water Reclamation Plant (NCWRP) and South Bay Water Reclamation Plant (SBWRP).

City's Current and Proposed Method

One of the key components of the cost of service study is the allocation of operation & maintenance costs (O&M) and capital costs to the wastewater parameters of flow, TSS and COD. As you know, we currently use the functional-design approach in allocating costs to the wastewater parameters for Metro Participating Agency (PA) billing purposes, and we have utilized this method for the current retail level study for City users. This current methodology is based on proportional cost sharing between the biochemical (BOD) and total suspended solids (TSS) parameters in the primary and secondary processes, i.e. the strength costs are allocated to COD and TSS in proportion to the relative removal of those two constituents of wastewater. For example, since the primary process at Pt Loma is required to remove 80 percent TSS and 58 percent BOD, we have allocated those costs to strength parameters in proportion to the removal of TSS and BOD. This method is also adopted consistently in allocating the NCWRP primary and secondary facilities costs and in allocating the capital costs.

The current O&M and capital cost allocations for the City's wastewater system are presented in Tables 1 through 5, of the Appendix.

Straight TSS Method (STSS)

Some stakeholder group members are not in favor of the cost allocation approach used by the City and have proposed an alternative, hybrid cost allocation approach, which they refer to as the "STSS Method." The major differences between the STSS Method and the current City approach relate to:

- ***Allocation of Point Loma Wastewater Treatment Plant Costs***: The proponents of the STSS method suggest that since Point Loma is an advanced primary plant designed to remove SS, all the costs allocated to strength should be assigned to TSS, except the incremental costs of removing excess TSS to meet OPRA's BOD requirement. OPRA's current requirement is to remove 58 percent BOD and 80 percent TSS. To meet the 58 percent BOD requirement, the City currently has to remove 86 percent TSS (the stakeholder group has used 85 percent instead of 86 percent and we will use their figure for simplicity). Therefore, according to this method only the costs incurred in removing the additional five percent TSS (85% TSS removal instead of the 80% removal required by the permit) should be allocated to COD. This results in a net strength allocation for Pt. Loma of 94 percent to TSS {80 (TSS)/[80(TSS) + 5(BOD)]} and the remaining 6 percent to COD. The Pt Loma cost allocations, based on the STSS method, are presented in the section entitled Treatment O&M, in Table 8 of the appendix.

- ***Allocation of Metro Biosolids Center Costs***: The STSS Method allocates Metro Biosolids costs in the same manner as the City's method. However, since the STSS method considers 94 percent of the solids coming from Pt Loma as TSS related, the costs are loaded relatively more on TSS than they are in the City's approach. The Metro Biosolids Center (MBC) cost allocations, based on the STSS method, are presented in the section entitled Treatment O&M, in Table 8.

- ***Allocation of Costs at NCWRP:*** The proponents of the STSS method advocate using the City's proportional allocations at NCWRP. While the City follows a consistent philosophy of proportional cost sharing in allocating primary costs at Pt. Loma and primary and secondary costs at NCWRP, the STSS method proposes different allocation philosophies for primary costs at NCWRP and Pt. Loma. Also, if we were to strictly follow the STSS method, the strength related secondary costs at NCWRP would be allocated entirely to BOD. However, the STSS method proponents have not done so, and have instead used the City's current method, which allocates the strength related costs to the relative amounts of BOD and SS removed in that process. As a result of these internal inconsistencies, we believe that the STSS method is flawed. The NCWRP cost allocations, based on the STSS method, are presented in the section entitled Treatment O&M, in Table 8.

- ***Allocation of Indirect Costs***: The STSS Method allocates indirect costs such as technical services costs and other indirect capital costs, based on the derived allocations of all direct costs. Please refer to the section entitled Technical Services Costs, in Table 8of the Appendix. While this approach may be reasonable, it is not consistent with our present method,

which was approved by the PAs. The City's current approach allocates technical services costs and non-specific capital costs roughly one-third each to Flow, TSS and COD. Please refer to Metro Technical Services Costs in Table 3 of the Appendix.

Summary and Conclusions

In summary, the STSS Method yields an allocation that is significantly different from that of the current approach, shifting a substantial cost burden from high strength dischargers of COD to dischargers of TSS. As we have illustrated above and in the appendix, there is an inherent, potentially fatal inconsistency in this hybrid allocation approach. While the STSS Method applies costs incrementally at Point Loma and Metro Biosolids facilities, it allocates costs proportionally at NCWRP and South Bay. Since the Metro system is a regional system that includes all the different facilities, we believe it is essential to use a consistent method in allocating the costs of the different facilities.

The inconsistencies in the STSS method could be eliminated if an Incremental Cost Approach is used in allocating the costs of all facilities, including NCWRP and South Bay . Under the Incremental Cost Approach, the strength related primary costs are allocated entirely to TSS and the strength related secondary costs are allocated entirely to BOD, assuming that the secondary process removes BOD. The cost allocation at MBC then assumes that the solids from the primary are TSS and the solids from the secondary are all BOD. The cost allocation results under this method are shown in Tables 11 through 15 of the appendix.

We believe (and we're confident you'll agree) that the cost allocation approach employed is critical to the accurate, defensible determination of unit costs of Flow, TSS and BOD/COD, which in turn could have significant impact on costs allocated to the different customer classes. Therefore, we request a review of the three cost allocation approaches discussed above and your feedback on the acceptability of the current City approach, the hybrid STSS approach suggested by some stakeholders, and the alternative Incremental Cost Approach.

Given the sensitivity of this issue, we would appreciate an early response from you. If you have questions of a general nature, please call me at (619) 235-5832; questions of a technical nature should be addressed to either Sudhir Pardiwala (949) 788-4234, or Prabha Kumar (949) 788-4236, of Black & Veatch.

Sincerely yours,

D. H. Kahlie
Utilities Finance Administrator

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CITY OF SAN DIEGO - COST OF SERVICE STUDY

CITY'S COST ALLOCATION METHODOLOGY

TABLE - 1

SUMMARY OF CITY COST ALLOCATION PERCENTAGE DERIVATIONS

Description	Functional - Design Method Wastewater Parameters		
	Flow	TSS	BOD/COD
	%	%	%
Total City O&M Cost	65.28%	19.62%	15.10%
Total City CIP	66.74%	17.21%	16.05%
OVERALL COST ALLOCATION	65.78%	19.19%	15.03%

Supplemental Information that shows the derivation of the above allocation percentages:

Tables 2 and 3 show the derivation of the O&M cost allocation percentages.

Tables 4 and 5 show the derivation of the capital cost allocation percentages.

TABLE - 2

Derivation of City O&M Cost Allocation Percentages (FY 1999)

Description	Amount $	Functional - Design Method Wastewater Parameters		
		Flow	TSS	BOD/COD
		%	%	%
City Collection System	50,000,000	100.00%	0.00%	0.00%
City Treatment - San Pasqual (1)	3,000,000	28.20%	40.36%	31.44%
Metro Treatment - City's Share (2)	60,000,000	41.14%	33.24%	25.62%
City Laboratory (3)	5,000,000	30.00%	40.00%	30.00%
City Total - Direct O&M Costs	118,000,000	65.28%	19.62%	15.10%
City Administration	11,000,000	65.28%	19.62%	15.10%
Total City O&M Cost	129,000,000	65.28%	19.62%	15.10%

NOTE

(1) Used Metro Treatment O&M allocation percentages.

(2) Used Total Metro Direct O&M allocation percentages.

(3) Used Metro Technical Services O&M allocation percentages.

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TABLE - 13

Derivation of Metro O&M Cost Allocation Percentages (FY 1999)

Description	Amount $	Functional - Design Method Wastewater Parameters		
		Flow %	TSS %	BOD/COD %
TOTAL TRANSMISSION & SYSTEM MAINT.				
Metro Pump Station #1 - O&M	2,453,240	100.00%	0.00%	0.00%
Metro Pump Station #2 - O&M	5,409,180	100.00%	0.00%	0.00%
Total Transmission	7,862,420	100.00%	0.00%	0.00%
TREATMENT O&M				
Point Loma Plant - O&M (1)	8,504,754	37.25%	62.75%	0.00%
Point Loma Plant - (2)	1,000,000	0.00%	0.00%	100.00%
Fiesta Island - O&M (3)	1,549,410	0.00%	94.00%	6.00%
North City Water Reclamation Plant (4)	6,059,985	75.00%	5.00%	20.00%
Metro Biosolids Center	11,111,539	0.00%	63.00%	37.00%
South Bay Water Reclamation Facility	190,672	75.00%	5.00%	20.00%
Total Treatment O&M	28,416,360	27.65%	49.64%	22.71%
TECHNICAL SERVICES				
Wastewater Chemistry	3,088,157	42.46%	39.98%	17.56%
Biology/Ocean Operations	2,726,235	42.46%	39.98%	17.56%
Total Technical Services	5,814,392	42.46%	39.98%	17.56%
COGENERATION				
Point Loma Cogeneration - O&M	738,515	0.00%	94.00%	6.00%
Hydro Electric Generation - O&M	0	100.00%	0.00%	0.00%
Total Cogeneration	738,515	0.00%	94.00%	6.00%
TOTAL METRO DIRECT O&M COSTS	42,831,687	42.46%	39.98%	17.56%
ADMIN & GENERAL/CLEAN WATER EXPENSE				
Total Metro General & Admin	30,143,844	42.46%	39.98%	17.56%
GRAND TOTAL - OPERATIONS	72,975,531	42.46%	39.98%	17.56%

NOTE

(1) Split of 33% flow and 67% strength follows City's proposed method.

(2) The cost of meeting OPRA's BOD requirement is $1 million according to deposition by Deputy Director in charge of PLTP.

(3) The first 80% of TSS removal incidently removes 55% of BOD. An additional 5% of TSS is removed to meet the 58% BOD requirement. Hence when normalized to 100%, 94% of PLTP solids derives from TSS removal and 6% derived from COD removal. Based on MBC cost attributed 62% to PLTP and 38% to NCWRP, per MBC operations personnel.

(4) Based on 100% secondary strength allocation to BOD

(5) Indirect and distributed costs are allocated per "grand total" split percentages.

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TABLE - 14

Derivation of City Capital Cost Allocation Percentages

Description	Amount $	Functional - Design Method Wastewater Parameters		
		Flow	TSS	BOD/COD
		%	%	%
Fund 41506 - City CIP (1)	33,000,000	100.00%	0.00%	0.00%
Fund 41508 & 41509 - Metro CIP (2	130,000,000	59.61%	28.98%	11.41%
Total City CIP	163,000,000	67.78%	23.12%	9.10%

TABLE - 15

Derivation of Capital Cost Allocation Percentage (FY 1997)

Description	Amount $	Functional - Design Method Wastewater Parameters		
		Flow	TSS	BOD/COD
		%	%	%
41508 - Direct Costs				
Chemical Feed Systems Upgrade	4,492,706	33.33%	56.15%	10.52%
Force Main 1& 2 Corrosion Study	2,732,984	100.00%	0.00%	0.00%
North Metro Interceptor	71,587,582	100.00%	0.00%	0.00%
Point Loma Digesters 1&2 Roofs & Heating	14,702,227	0.00%	94.00%	6.00%
Point Loma Headworks, Odor Control & Grit	53,373,029	95.00%	5.00%	0.00%
Pt. Loma Power Gen. & Dist. Upgrade	19,105,763	59.61%	30.10%	10.30%
Pt. Loma Scum Removal System	15,602,976	100.00%	0.00%	0.00%
Pt. Loma Sedimentation Basins 11 & 12	8,745,218	33.33%	56.15%	10.52%
Pt. Loma Water Tank & Pipeline	3,386,608	59.61%	30.10%	10.30%
South Effluent Outfall Channel	24,385,073	100.00%	0.00%	0.00%
South Metro Interceptor Rehab	25,143,869	100.00%	0.00%	0.00%
Rehabilitation of On-shore Outfall	2,232,755	100.00%	0.00%	0.00%
Pt. Loma Outfall Reballasting	7,737,836	100.00%	0.00%	0.00%
Trucked Liquid Waste Disposal Site	1,786,530	100.00%	0.00%	0.00%
41508 - Distributed Costs				
Annual Allocation Pt. Loma	13,947,464	59.61%	30.10%	10.30%
Pt. Loma North Operations Building	9,284,519	59.61%	30.10%	10.30%
Pt. Loma Plant Access Road	925,738	59.61%	30.10%	10.30%
MOC Central Repair Facility	4,593,406	59.61%	30.10%	10.30%
Pt. Loma Parking Facility	287,135	59.61%	30.10%	10.30%
Pt. Loma Shoreline Protection	2,257,794	59.61%	30.10%	10.30%
41509 - Direct Costs				
FIRP Pump Station	42,550,695	0.00%	94.00%	6.00%
SOP Compliance Facilities, Phase I	2,755,308	100.00%	0.00%	0.00%
SOP Compliance Facilities, Phase II (Extn.)	68,221,098	100.00%	0.00%	0.00%
Modified WW Treatment SOP	1,315,868	0.00%	0.00%	100.00%

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FIRP Phase II Digested Sludge & Centrate	32,675,478	0.00%	94.00%	6.00%
NSPF-Phase II	241,031,074	0.00%	77.00%	23.00%
San Diego River Outfall	5,156,781	100.00%	0.00%	0.00%
Point Loma Tunnel Outfall	14,290,851	100.00%	0.00%	0.00%
East Bay Mission Bay Effluent Pipeline	1,902,816	100.00%	0.00%	0.00%
North City Effluent Pipeline	1,652,159	100.00%	0.00%	0.00%
North City Raw Sludge & Water Pipelines	18,308,848	0.00%	50.00%	50.00%
North City Sludge Processing Facility	2,826,778	0.00%	50.00%	50.00%
North City Tunnel Conector	12,357,836	100.00%	0.00%	0.00%
North City Water Recalmation Plant	189,561,944	75.00%	5.00%	20.00%
Otay Valley Effluent Pipeline	65,093	100.00%	0.00%	0.00%
Pt. Loma Digester Facility Upgrade & Expn.	74,878,882	0.00%	94.00%	6.00%
Rose Canyon Trunk Sewer CWP Portion*	12,168,826	100.00%	0.00%	0.00%
Sludge and Biolsolids Management Facility	1,176,019	0.00%	94.00%	6.00%
South Bay Land Outfall	20,642,133	100.00%	0.00%	0.00%
Southbay Outfall Extension	161,219,506	100.00%	0.00%	0.00%
South Bay Water Reclamation Sewers	27,624,095	100.00%	0.00%	0.00%
Southbay Sludge Processing Facilities	26,072,628	0.00%	50.00%	50.00%
Pt. Loma Secondary Conversion	14,000	35.00%	15.00%	50.00%
Southbay Secondary Sewers - Phase I*	34,137,788	100.00%	0.00%	0.00%
Southbay Secondary Sewers - Phase II*	50,078	100.00%	0.00%	0.00%
Otay Valley Sludge Pipeline	60,628	0.00%	50.00%	50.00%
South Bay Water Reclamation/Sec Plants	109,464,536	75.00%	5.00%	20.00%
South East Otay Mesa Sludge Pipelines	30,902	0.00%	50.00%	50.00%
Santee Water Reclamation Plant - Phase II	203	75.00%	5.00%	20.00%
Dairy mart Road and Bridge Improvements	19,629,620	59.61%	30.10%	10.30%
Mission Gorge Water Reclamation Plant	56,881	75.00%	5.00%	20.00%
Mission Valley Effluent Pipeline	66,216	100.00%	0.00%	0.00%
Mission Valley sludge pipeline	66,493	0.00%	50.00%	50.00%
Mission Valley Water Reclamation Plant	670,778	75.00%	5.00%	20.00%
M.Valley Water Reclamation Plant - Phase II	14,956,857	75.00%	5.00%	20.00%
Otay Valley Reclamation Plant	311,734	75.00%	5.00%	20.00%
Pt. Loma S Bay Sludge Pipeline	4,474	0.00%	50.00%	50.00%
North City Co-Generation Facility*	1,830,388	75.00%	5.00%	20.00%
San Pasqual Sludge Land Applic. Facility	2,288	0.00%	50.00%	50.00%
TOTAL METRO 41508 & 41509 DIRECT CIP COSTS	**1,426,119,792**	**59.61%**	**28.98%**	**11.41%**

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APPENDIX 6-2
SWRCB RESPONSE

Winston H. Hickox
Secretary for
Environmental
Protection

Division of Clean Water Programs
1001 I Street • Sacramento, California 95814 • (916) 341-5642
Mailing Address: P.O. Box 944212 • Sacramento, California • 94244-2120
FAX (916) 341-5707 • Internet Address: http://www.swrcb.ca.gov

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Gray Davis
Governor

The energy challenge facing California is real. Every Californian needs to take immediate action to reduce energy consumption. For a list of simple ways you can reduce demand and cut your energy costs, see our Web-site at http://www.swrcb.ca.gov.

Mr. D. H. Kahlie
City of San Diego
Financing Services
202 C Street, MS 7B
San Diego, CA 92101

Dear Mr. Kahlie:

WASTEWATER REVENUE PROGRAM COST ALLOCATION METHODOLOGY – CITY OF SAN DIEGO, CLEAN WATER GRANT (CWG) PROJECTS NO. C-06-1092 AND C-06-3014; STATE REVOLVING FUND (SRF) LOAN PROJECTS NO. C-06-4119, C-06-4383, C-06-4542, C-06-4650, C-06-4690 AND C-06-4718

I have reviewed your letter, dated May 22, 2001, requesting a review of three different methods of cost allocation for wastewater treatment costs.

REVIEW

The three methods, outlined in your letter, of allocating operation, maintenance and capital costs to the parameters of flow, TSS and BOD are:

(1) The City's current user charge system. This method allocates costs by functional design and percentage of TSS and BOD removal at the various city treatment plants. This method results in a user charge system that allocates all users in the city and participating agencies (cities and districts outside San Diego) the same unit cost for wastewater treatment services. This method results in the overall allocation of costs as follows: 65.78 percent to flow, 19.19 percent to TSS and 15.03 percent to BOD.

(2) Straight TSS Method (STSS). This method is proposed by a stakeholders group of industrial users discharging to the Point Loma Plant. The STSS method allocates 94 percent of the strength allocation costs at Point Loma to TSS removal and 6 percent to BOD removal. This is based on the claim that the NPDES permit requires the City to remove 58 percent of BOD and 80 percent of TSS at Point Loma. The City removes approximately 86 percent of TSS to meet the NPDES requirement of 58 percent BOD removal. Because the City must remove additional TSS, above the 80 percent requirement, to meet the BOD requirement, the stakeholders group believes only the additional cost of removing TSS in excess of the 80 percent requirement should be charged to BOD removal. The costs at the Metro Biosolids Center are also skewed towards TSS costs based on the proposed revision of costs at Point Loma.

The STSS proposal retains the existing method (see No. 1 above) allocation of costs at the North City Water Reclamation Plant (NCWRP) and, presumably, at the South Bay Water Reclamation Plant (SBWRP)

Indirect costs are allocated based on the derived allocations of the direct costs. This method results in the overall allocation of costs as follows: 66.92 percent to flow, 25.46 percent to TSS and 7.61 percent to BOD.

(3) Modified TSS Method. This method proposes allocation of costs at NCWRP and SBWRP on the same basis as the STSS method proposes for Point Loma costs.

This method results in the overall allocation of costs as follows: 66.92 percent to flow, 23.23 percent to TSS and 9.85 percent to BOD.

ANALYSIS AND COMMENT

The City's existing method of allocating costs, the functional design approach, has been previously reviewed and approved by this office. This method is utilized by numerous agencies in California. In addition, the existing method is outlined in the service contract between the City and the Participating Agencies receiving treatment and disposal service from the City. Therefore, the City is contractually required to use this method for determining the Participating Agencies' share of the City's cost of wastewater treatment and disposal.

The assumption behind the STSS method seems to be that the 80-percent TSS removal requirement in the NPDES permit is separate and independent of the 58-percent BOD removal requirement. Therefore, even though the cost of removing 80 percent of the TSS loading also removes a significant portion of the BOD loading, the STSS method allocates all of the cost of removing 80 percent of the TSS only to the TSS parameter. Only the incremental cost of removing additional TSS to meet the BOD removal requirement is allocated to the BOD parameter.

The STSS method, as proposed, would not comply with CWG program regulations and SRF program guidelines unless the following issues were resolved:

1. The cost of removing the additional TSS (6 percent) may not be proportional to the cost of removing the first 80 percent of TSS. The City would need to develop data demonstrating the actual cost of removing various levels of TSS. The City would also need to provide a logical reason to justify using an incremental cost method as opposed to a proportional cost method for that portion of TSS removed above 80 percent.

2. The City would need to justify the rational of assigning O & M cost to the BOD parameter for that portion of BOD removed with the first 80 percent of TSS removed.

3. If either the STSS method or the modified STSS method were used for the City of San Diego, dischargers outside of the City with similar loadings would not have their costs calculated on the same basis as dischargers located inside the City. Previous Clean Water Grant contracts between the City and the State of California contain a provision that the City treat all recipients of wastewater treatment service in a fair and equitable manner. The service contract between the City and the PA's does not permit either the STSS method nor the Modified STSS method of allocating costs to the PA's. Therefore, before either method could be considered by this office, the City would need to demonstrate that the PA's would accept amendment of the service contract to permit the utilization of either method to calculate the PA's share of costs.

If you have any questions regarding this letter, please call me at (916) 341-5642.

Sincerely,

Ronald R. Blair
Revenue Program Specialist

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APPENDIX 8-1
COMMERCIAL/INDUSTRIAL (> 25,000 GPD DISCHARGE) CHARGES

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City of San Diego

Large User Monthly Charges and Rates ($9.93 Monthly Base Fee)

NAME OF USER	RETURN %	TSS (MG/L)	COD (MG/L)	Monthly Usage 2002 (HCF)	Proposed: Monthly Flow 2002 (HCF)	Proposed: Estimated Monthly Usage Charges ($)	Proposed: Monthly Base Fee ($)	Proposed: Estimated Monthly Sewer Charges ($)	Proposed: 2003 Rate $/hcf/WW ($)
PEPSI-COLA BOTTLING CO	47%	1438	6010	2,821	1,326	$13,545.94	$9.93	$13,555.87	10.216
PEPSI-COLA BOTTLING CO	47%	1438	6010	2,221	1,044	$10,665.13	$9.93	$10,675.06	10.216
COCA COLA BOTTLING CO	47%	215	300	7,215	3,391	$9,498.53	$9.93	$9,508.46	2.802
SSE MANUFACTURING INC	72%	500	300	1,644	1,184	$4,068.51	$9.93	$4,078.44	3.437
HYDRANAUTICS	97%	10	2300	2,147	2,083	$8,304.13	$9.93	$8,314.06	3.987
LIMAR REALTY CORP #14	97%	250	300	1,296	1,257	$3,619.03	$9.93	$3,628.96	2.880
DURA PHARMACEUTICAL	52%	250	300	2,052	1,067	$3,072.00	$9.93	$3,081.93	2.880
IDEC PHARMACEUTICALS	77%	17	1742	2,561	1,972	$6,988.76	$9.93	$6,998.69	3.544
THE NUTRASWEET KELCO CO	82%	323	3790	63,341	51,940	$306,847.84	$9.93	$306,857.77	5.908
THE NUTRASWEET KELCO CO	82%	88	9036	39,837	32,666	$316,598.23	$9.93	$316,608.16	9.692
TOPPAN WEST INCORP	92%	56	721	4,380	4,030	$11,253.67	$9.93	$11,263.60	2.793
TOPPAN WEST INCORP	97%	56	721	4,108	3,985	$11,128.01	$9.93	$11,137.94	2.793
SOLAR TURBINES INC	67%	250	1200	2,855	1,913	$6,921.56	$9.93	$6,931.49	3.619
TELEPHONE RL EST EQUITY	62%	250	1200	1,877	1,164	$4,211.55	$9.93	$4,221.48	3.619
KYOCERA AMERICA INC	97%	16	57	2,611	2,533	$5,466.37	$9.93	$5,476.30	2.159
APPLIED MICRO CIRCUITS CO	77%	660	60	2,009	1,547	$5,562.60	$9.93	$5,572.53	3.596
QUALCOMM INC	92%	250	300	1,328	1,222	$3,518.26	$9.93	$3,528.19	2.880
SONY CORP OF AMERICA	82%	25	173	3,728	3,057	$6,949.71	$9.93	$6,959.64	2.274
HEWLETT-PACKARD CO	62%	250	300	3,535	2,192	$6,310.98	$9.93	$6,320.91	2.880
SONY CORP OF AMERICA	82%	25	173	2,298	1,884	$4,283.04	$9.93	$4,292.97	2.274
SONY CORP OF AMERICA	82%	25	173	23,722	19,452	$44,221.74	$9.93	$44,231.67	2.274
SOUTHWEST MARINE	77%	250	300	1,799	1,385	$3,987.55	$9.93	$3,997.48	2.880
NATL STEEL & SHIPBUILDING	97%	210	937	1,719	1,667	$5,522.86	$9.93	$5,532.79	3.314
PACIFIC BELL	87%	300	600	3,426	2,981	$9,649.15	$9.93	$9,659.08	3.237
PF CHANG'S CHINA BISTRO	97%	640	2000	1,111	1,078	$5,545.52	$9.93	$5,555.45	5.145
SKY CHEF	87%	640	2000	1,246	1,084	$5,576.39	$9.93	$5,586.32	5.145
HAHN INC,ERNEST W	92%	250	600	1,475	1,357	$4,241.24	$9.93	$4,251.17	3.126
HOLIDAY INN INC	87%	400	800	1,376	1,197	$4,337.90	$9.93	$4,347.83	3.624
J C RESORTS INC	82%	400	800	1,537	1,260	$4,566.22	$9.93	$4,576.15	3.624
J C RESORTS INC	87%	400	800	2,434	2,118	$7,675.59	$9.93	$7,685.52	3.624
US GRANT HOTEL	67%	400	800	2,454	1,644	$5,957.82	$9.93	$5,967.75	3.624
PICKWICK PARTNERS	97%	400	800	1,360	1,319	$4,780.03	$9.93	$4,789.96	3.624
GOLDEN WEST HOTEL	97%	400	800	1,160	1,125	$4,076.98	$9.93	$4,086.91	3.624
SHERATON CALIF CORP	92%	400	800	6,107	5,618	$20,359.52	$9.93	$20,369.45	3.624
SHERATON HARBOR ISLAND	77%	400	800	1,408	1,084	$3,928.40	$9.93	$3,938.33	3.624
FORTE TRAVELODGE HOTEL	87%	400	800	1,472	1,281	$4,642.32	$9.93	$4,652.25	3.624
ATLAS HOTELS INC	72%	400	800	4,139	2,980	$10,799.46	$9.93	$10,809.39	3.624
HOLIDAY INN	77%	400	800	2,196	1,691	$6,128.15	$9.93	$6,138.08	3.624
TARSAIDA INC	92%	250	800	1,320	1,214	$3,993.69	$9.93	$4,003.62	3.290
WESLEY PALMS	42%	250	800	3,029	1,272	$4,184.49	$9.93	$4,194.42	3.290
CATAMARAN HOTEL	87%	400	800	2,215	1,927	$6,983.41	$9.93	$6,993.34	3.624
SAN DIEGO HILTON	67%	400	800	2,154	1,443	$5,229.40	$9.93	$5,239.33	3.624
DE ANZA CAMPLND MSSN BA	42%	250	800	3,050	1,281	$4,214.10	$9.93	$4,224.03	3.290

APPENDIX 9-1
REGIONAL WASTEWATER DISPOSAL AGREEMENT

DRAFT

REGIONAL WASTEWATER DISPOSAL AGREEMENT

BETWEEN

THE CITY OF SAN DIEGO

AND

THE PARTICIPATING AGENCIES

IN

THE METROPOLITAN SEWERAGE SYSTEM

DOCUMENT NO. 00-18517

FILED MAY 18 1998

OFFICE OF THE CITY CLERK
SAN DIEGO, CALIFORNIA

REVISED 3/2/98

REGIONAL WASTEWATER DISPOSAL AGREEMENT

TABLE OF CONTENTS

REGIONAL WASTEWATER DISPOSAL AGREEMENT

THIS REGIONAL WASTEWATER DISPOSAL AGREEMENT is made and entered into this _____ day of _____, 1997, by and between the CITY OF SAN DIEGO, a municipal corporation ("the City"); and the CITY OF CHULA VISTA, a municipal corporation; the CITY OF CORONADO, a municipal corporation; the CITY OF DEL MAR, a municipal corporation; the CITY OF EL CAJON, a municipal corporation; the CITY OF IMPERIAL BEACH, a municipal corporation; the CITY OF LA MESA, a municipal corporation; the LEMON GROVE SANITATION DISTRICT, a political subdivision of the State of California; the CITY OF NATIONAL CITY, a municipal corporation; the CITY OF POWAY, a municipal corporation; the WINTER GARDENS SEWER MAINTENANCE DISTRICT, a maintenance district established pursuant to California Streets & Hwys. Code section 5820 et seq.; the ALPINE SANITATION DISTRICT, a political subdivision of the State of California; the LAKESIDE SANITATION DISTRICT, a political subdivision of the State of California; the SPRING VALLEY SANITATION DISTRICT, a political subdivision of the State of California; the OTAY WATER DISTRICT, a political subdivision of the State of California; and the PADRE DAM MUNICIPAL WATER DISTRICT, a political subdivision of the State of California (the "Participating Agencies").

RECITALS

WHEREAS, the City and the Participating Agencies are autonomous entities each having the authority to provide and to contract for the conveyance, treatment and disposal of wastewater.

WHEREAS, each Participating Agency currently has a contract with the City to provide wastewater conveyance, treatment and disposal services through the Metropolitan Sewerage System (Metro System), a system of wastewater conveyance, treatment and disposal facilities.

WHEREAS, each of the Participating Agencies has specified capacity service rights in the existing Metro System pursuant to pre-existing agreements with the City.

WHEREAS, the purposes of this Agreement are: 1) to replace the existing sewage disposal agreements between the City and the Participating Agencies; 2) to provide certain contract rights to capacity in the Metro System to the Participating Agencies; 3) to establish a mechanism to fund the planning, design, construction, operation and maintenance of the Metro System by the City and the Participating Agencies as necessary to provide hydraulic capacity, and to comply with applicable law and with generally accepted engineering practices; and 4) to establish a system of charges which allocates the costs of the planning, design and construction of such new wastewater conveyance, treatment and disposal facilities as are necessary solely to provide for new capacity on a fair and equitable basis.

THEREFORE, in consideration of the mutual promises set forth herein, the City and the Participating Agencies agree as follows:

I. DEFINITIONS

A. **Annual Average Daily Flow** is the number, in millions of gallons of wastewater per day ("MGD"), calculated by dividing total Flow on a fiscal year basis by 365 days.

B. **Capital Improvement Costs** are costs associated with the planning, design, financing, construction, or reconstruction of facilities.

C. **Chemical Oxygen Demand or "COD"** means the measure of the chemically decomposable material in wastewater, as determined by the procedures specified in the most current edition of "Standard Methods for the Examination for Water and Wastewater," or any successor publication which establishes the industry standard.

D. **Contract Capacity** is the contractual right possessed by each Participating Agency to discharge wastewater into the Metro System pursuant to this Agreement up to the limit set forth in Exhibit B attached hereto. Contract Capacity is stated in terms of Annual Average Daily Flow.

E. **Flow** is the amount of wastewater discharged by the City and each Participating Agency.

F. **Functional-Design Methodology** shall mean the process of allocating Operation and Maintenance Costs and Capital Improvement Costs to Flow and Strength parameters recognizing the benefits of both the design criteria and the primary function of a unit process.

G. **Metro System Costs** are those costs set forth in Section V.B.1.

H. **Metro System Revenues** are those revenues set forth in Section V.B.2.

I. **Metropolitan Sewerage System or Metro System** shall mean and consist of those facilities and contract rights to facilities which are shown and/or described in Exhibit A attached hereto and incorporated by this reference, including any amendments thereto authorized by this Agreement.

J. **Municipal System** shall mean the City's wastewater collection system, which consists of pipelines and pump stations, that collects wastewater within the City

of San Diego and conveys it to the Metropolitan Sewerage System for treatment and disposal.

K. New Capacity is the capacity to discharge wastewater outside the Metro System, above the Contract Capacity set forth in Exhibit B attached hereto.

L. New Contract Capacity is the capacity to discharge wastewater into the Metro System, above the Contract Capacity set forth in Exhibit B attached hereto.

M. North City Water Reclamation Plant is the 30 million gallons per day (as of the date of this Agreement) wastewater treatment facility which includes four major processes: primary treatment, secondary treatment, tertiary treatment, and disinfection.

N. Operation and Maintenance Costs are the costs of those items and activities required by sound engineering and management practices to keep the conveyance, disposal, treatment, and reuse facilities functioning in accordance with all applicable laws, rules, and regulations.

O. Point Loma Wastewater Treatment Plant is the 240 million gallons per day (as of the date of this Agreement) advanced primary treatment plant which includes four major processes: screening, grit removal, sedimentation, and digestion.

P. Reclaimed Water (or Recycled Water) shall have the definition set forth in Title 22, Division 4 of the California Code of Regulations and shall mean water which, as a result of treatment of wastewater, is suitable for a direct beneficial use or a controlled use that otherwise could not occur.

Q. Reclaimed Water (or Recycled Water) Distribution System shall mean and consist of those eight (8) reclaimed water projects listed in Attachment B of the Stipulated Final Order for Injunctive Relief approved by the U.S. District Court on June 6, 1997 in U.S.A. v. City of San Diego, Case No. 88-1101-B, and attached hereto as Exhibit E.

R. Repurified Water shall mean water which, as a result of advanced treatment of reclaimed water, is suitable for use as a source of domestic (or potable) water supply.

S. Return Flow shall mean the effluent created by the dewatering of digested biosolids, which includes centrate.

T. Reuse shall mean to use again, such as water which has been reclaimed or repurified, or sludge that has been converted to biosolids for beneficial use.

U. South Bay Land/Ocean Outfall is the facility that is jointly owned by the International Boundary & Water Commission (U.S. Section IBWC) and the City of San Diego. The Outfall is planned to convey and discharge treated effluent from the IBWC's International Wastewater Treatment Plant and treated effluent from the City's South Bay Water Reclamation Plant and the South Bay Secondary Treatment Plant. As of the date of this Agreement, the Outfall has a current Average Daily Flow Capacity of 174 million gallons per day . As of the date of this Agreement, the City owns 39.94% of the capacity of the Outfall and the balance of the capacity is owned by the IBWC.

V. Strength means the measurement of Suspended Solids (SS) and Chemical Oxygen Demand (COD) within the wastewater Flow and any other measurement required by law after the date of this Agreement.

W. "Suspended Solids" or "SS" means the insoluble solid matter in wastewater that is separable by laboratory filtration, as determined by the procedures specified in the most current edition of "Standard Methods for the Examination of Water and Wastewater," or any successor publication which establishes the industry standard.

X. Tertiary Component is that portion of the wastewater treatment process that currently filters the secondary treated wastewater effluent through fine sand and/or anthracite coal to remove fine Suspended Solids and disinfects it to meet the requirements of the California Administrative Code, Title 22, or its successor for filtered and disinfected wastewater.

Y. Water Repurification System includes the Advanced Water Treatment (AWT) Facility located at or near the North City Water Reclamation Plant site and the Repurified Water Conveyance System which will transport repurified water from the AWT Facility to the San Vicente Reservoir. The major processes of the AWT Facility include: ultra or micro filtration, reverse osmosis, and ozonation.

II. OWNERSHIP AND OPERATION OF THE METRO SYSTEM

A. Rights of the Parties.

The City is the owner of the Metro System, and of any additions to the Metro System or other facilities constructed pursuant to this Agreement. All decisions with respect to the planning, design, construction, operation and maintenance of the Metro System shall rest with the City, in consultation with the Metro Commission. The Participating Agencies shall have a contractual right to use the Metro System and to participate in its operation as set forth in

EXHIBIT 4

CITY OF SAN DIEGO
MEMORANDUM

DATE: October 6, 1999

TO: Honorable Mayor and City Council

FROM: George Loveland, Deputy City Manager

SUBJECT: Water and Sewer Cost of Service Studies

Transmitted herewith for your information and review are copies of the Water and Sewer Cost of Service Studies which were undertaken during late FY 1997 and FY 1998 as a part of the rate analysis process.

The studies, which were performed by the consulting team of Pinnacle One and Chester Engineers, were utilized by staff to insure that the then-existing and proposed rate structures for the water and sewer utilities were consistent with the requirements of Proposition 218, and to identify alternative approaches which could be considered if the need arose.

Our conclusion, based on the studies and extensive internal review, was and is that the water and sewer rate structures adopted by the Council are both business-friendly and consistent with the requirements of Proposition 218. This being the case, no changes are needed or recommended at this time.

Should you or your staff have questions with respect to the Studies, please let me know.

GEORGE LOVELAND
Deputy City Manager

DHK

EXHIBIT 5

257157
Wastewater hot 03_01_06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3DD9FC69.CAB7-9.FM.100.1357474.1.988F.1]
From: [Kelly Salt]
To: [;Dennis Kahlie;DKahlie@sandiego.gov]
Subject: [Closed Session memo]
Creation date: [11/19/2002 8:55:02 AM]
In Folder: [Sewer Cost of Service]
Attachment File name: [c:\44923\DKahlie\3631.1-SRF MemoFinal_CL.wpd]
Message: [
see attached

]

ATTORNEY TO CLIENT CORRESPONDENCE

FOR CONFIDENTIAL USE ONLY

Office of
The City Attorney
City of San Diego

MEMORANDUM

236-6220

DATE: November 14, 2002

TO: Honorable Mayor and City Council

FROM: Mary Vattimo, City Treasurer and Kelly J. Salt, Deputy City Attorney

SUBJECT: Significant Exposure to Litigation: Metropolitan Wastewater Department's Compliance With Federal and State Loan and Grant Guidelines

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RECOMMENDATION — Direct the City Manager to perform and implement the findings of a Cost of Service Study [CSS] for the City of San Diego's [City] sewer rates and charges, and bring such sewer rates and charges into compliance with Federal Clean Water Act grant conditions and State Revolving Fund loan requirements by ensuring the City's wastewater user fees be proportionate to the cost of providing the services.

COUNCIL DISTRICT: All

INTRODUCTION

Recently, a question was raised about the need to perform and implement the findings of a cost of service study of the City's wastewater user fees and charges. This memorandum addresses that issue.

In sum, the City currently has approximately $370 million in outstanding loans and grants related to improving the Metropolitan Wastewater System. A condition of those grants and loans is that

the City's user fees and charges be "proportionate." To ensure compliance with these conditions, the City must perform a Cost of Service Study of the City's sewer rates and charges. Failure to comply with these conditions and requirements may result in litigation for the repayment of the grant monies and acceleration of the repayment of the loan monies. Additionally, failure to comply may result in the loss of future State Revolving Loan Fund [SRF] loan monies.

BACKGROUND

A. Clean Water Grants and State Revolving Fund Loans

Since the late 1970's, the Metropolitan Wastewater Department [MWWD] has received a series of federal and state Clean Water Grants and SRF loans, that have provided the City financial assistance for the construction and improvement of the City's Metropolitan Sewerage System. Each of these grants and loans has required that the City adopt and maintain a user charge system that complies with the Clean Water Act [33 U.S.C. § 1251, *et seq.*] For example, the November 2, 2000 SRF Loan Match Program Contract Between the State Water Resources Control Board [State Board] and the City, provides that the City shall adopt and maintain in effect a user charge system which at all times complies with the requirements of Section 204(b)(1) of the federal Clean Water Act and applicable federal and state rules, regulations and guidelines. Specifically, the Clean Water Act requires a user charge system that charges users in proportion to the cost of providing treatment services. *See* 33 U.S.C. § 1284(b) and 40 C.F.R. § 35.2140.

The SRF loan program is a joint federal and state program that loans money at a low interest rate to local agencies for construction of wastewater treatment and water reclamation facilities, correction of non-point source and storm drainage pollution problems, and implementation of estuary enhancement activities. The SRF loan program replaced prior Clean Water Act grants and in 1987 was established by amendments to the Clean Water Act. The State Board is the California agency responsible for administering the SRF loan program.

To date, MWWD has received, or has existing proposals for, a total of approximately $370 million in grants and loans under the Clean Water Act grant and SRF loan programs. Approximately $114 million of that amount consists of outstanding SRF loans, with an additional $33 million in the process of being approved. MWWD anticipates it will remain active in the loan application process over the next few years.

Throughout most of the 1980s, when MWWD's wastewater treatment system performed only primary wastewater treatment, MWWD's user charge system moved gradually toward compliance with the Clean Water Act, and, briefly, in the late 1980s, the user charge system was in compliance. With the introduction of secondary treatment facilities in the City's Metropolitan Sewerage System, and the City becoming subject to a revised National Pollutant Discharge

Elimination System [NPDES] permit, which required removal of biological components from effluent, the user charge system again became non-compliant.

In the interim, MWWD has continued to enter into SRF loans requiring compliance with the Clean Water Act's proportionate fee system. In its SRF loan applications, MWWD has represented that its user charge system is in compliance with all federal and state requirements.

B. NPDES Permit for Discharge of Effluent at the Point Loma Ocean Outfall

On November 9, 1995, the United States Environmental Protection Agency [USEPA] and the Regional Board jointly issued the City a permit, for the City's E.W. Blom Point Loma MWWD Plant [Point Loma] for discharge into the Pacific Ocean through the Point Loma Ocean Outfall. The Permit established requirements for a discharge of up to 205 million gallons per day of advanced primary treated effluent.

On February 11, 2002, the USEPA and the California Regional Water Quality Control Board [Regional Board] jointly proposed issuance of a draft renewal of the Permit. As modified, the Permit will continue the initial Permit's requirement that the City remove 80% of Total Suspended Solids [TSS] and 58% of Biochemical Oxygen Demand [BOD] from the effluent discharged from the Point Loma Ocean Outfall. The Final Permit was issued September 13, 2002 and became effective October 16, 2002.

C. MWWD Cost of Service Study

In 1999, at the direction of the City Council, the City Treasurer's office on behalf of MWWD began the process of preparing a CSS for the City's Metropolitan Sewerage System. By April 2000, a consultant had been selected and had begun preparing the CSS.

The CSS was intended to determine how, if at all, MWWD's user charge system must be modified to make the City's cost allocation method for wastewater treatment costs compliant with the Clean Water Act. Specifically, the issue was whether, and if so, how, the City's cost allocation system must be modified to take into account the costs of removing biological components (BOD or Chemical Oxygen Demand [COD]) from wastewater. In conjunction with the CSS, a stakeholder's group of industrial users discharging to Point Loma was also selected to meet and offer recommendations concerning the CSS.

The Regional Board is aware that the City has undertaken the CSS. A final draft of the CSS was prepared for presentation and adoption by the City Council; however, due to concerns raised in a prior closed session with the City Council regarding the matters discussed herein, finalization of the report and its presentation was delayed. As a result of that delay, changes in municipal

wastewater flow volumes and other factors, the CSS will require updating to insure that an equitable apportionment of current costs is achieved prior to its presentation and adoption by the Council.

D. MWWD's Allocation of Wastewater Treatment Costs

(1) Existing Allocation of Wastewater Treatment Costs

In addition to providing service for its retail customers throughout the City, MWWD provides transportation, treatment and disposal of wastewater for fifteen other cities and water/sanitation districts [Participating Agencies].[1] MWWD provides service to the Participating Agencies on a contract basis. Before 1997, the Participating Agencies were charged for the costs incurred in processing their wastewater solely based on quantity. Following a review and audit of the City's user fee system, the State Board determined that the fee system for the Participating Agencies did not comply with the Clean Water Act because it relied solely on the flow of wastewater. To become compliant, the State Board required the City to use a strength-based billing system that would include, in addition to flow, charges for wastewater strength, as determined by sampling and testing for TSS and BOD. In response, and for administrative reasons, MWWD proposed using TSS and COD to measure strength. The State Board approved this method in November 1997. This is the method that MWWD has used for billing the Participating Agencies since 1997.

In contrast, MWWD's retail customers are charged based on the components of flow and TSS. There is no biological component, either BOD or COD, to the retail customer's user charge system.

(2) Proposed Changes to the Allocation of Wastewater Treatment Costs

In a May 2001 letter to the State Board, the City, in conjunction with the stakeholders group involved in the CSS, presented three alternative cost allocation methodologies for review and possible approval. The three alternative methodologies were:

(a) Allocating to all users, both Participating Agencies and retail customers, the same unit cost for wastewater treatment services, based on percentage of TSS and BOD removal at various MWWD plants. Overall allocation under this method would be:

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[1] The participating agencies are: the Cities of Chula Vista, Coronado, Del Mar, El Cajon, Imperial Beach, La Mesa, National City and Poway; and the Lakeside-Alpine Sanitation District, Lemon Grove Sanitation District, East Otay Mesa Sewer Maintenance District, Otay Water District, Spring Valley Sanitation District, Padre Dam Municipal Water District and the Wintergardens Sewer Maintenance District.

65.73% to flow, 18.87% to TSS, and 15.40% to BOD. [This approach is consistent with that utilized for billing the Participating Agencies since 1997.]

(b) Straight TSS Method [STSS]. This method would retain method (a), above, at all MWWD treatments plants other than Point Loma. For Point Loma, it would allocate 94% of the strength allocation costs to TSS removal and six percent to BOD removal. This allocation method is based on the premise that the City's NPDES Permit requires removal of 58% BOD and 80% TSS at Point Loma. However, the processes used to achieve the 58% BOD removal *also* results in the removal of 86% TSS. Because satisfying the NPDES permit for BOD removal results in the removal of 86% TSS, this stakeholder sponsored proposal would allocate all O&M and capital costs to TSS up to the cost to achieve 80% TSS, then shift all remaining costs to achieve TSS from 80% to 86% only to BOD. Overall allocation under this method would be: 66.92% to flow, 25.46% to TSS, and 7.61% to BOD.

(c) Modified TSS Method. This method would extend method (b), above, to all three MWWD treatment pants. Overall allocation under this method would be: 66.92% to flow, 23.23% to TSS, and 9.85% to BOD.

In a July 2001 letter responding to the City's submitted alternatives, the State Board specifically disapproved methods (2) and (3), above, noting that the City's NPDES permit requires removal of *both* BOD and TSS and therefore, the cost allocations must be fully proportionate to both BOD and TSS from the start. The State Board's position is that methods (2) and (3) fail to allocate any costs to BOD until the TSS removal requirement has been met. Therefore, these methods both fail to comply with the Clean Water Act requirement that costs be allocated proportionately.

Finally, the State Board letter provided that, before the State Board would approve a new method of cost allocation, the City must provide data that demonstrate that the allocation was proportional to actual costs, as required by the Clean Water Act. The revenue program guidelines for SRF loans provide that the City must have a Regional Board approved revenue program in place as a condition of receiving its SRF loan, and that any City rate changes must be reviewed and approved by the State Board.

DISCUSSION

Although MWWD has not been in compliance with Clean Water Act standards for its user charge system through much of the time it has been receiving the Clean Water grants and loans, MWWD has generally been moving toward compliance, e.g., the City added strength-based billing for

Participating Agencies in 1997; and, in 1999, the City began preparing the COSS to determine what, if any, changes are required for the City user fee system to comply.

The typical loan contract that MWWD has entered into for financial assistance for the construction and improvement of the City's Metropolitan Sewerage System includes an acceleration provision. This provision permits immediate acceleration of the loan if the City violates a material provision of the contract.

While the State Board has not provided written notice of termination of any of the loan contracts, the State Board staff, in conversations with MWWD staff, has indicated that MWWD's user charge system does not comply with the Clean Water Act. Additionally, the State Board is aware that the City has undertaken the COSS. The typical loan contract provides that, in any litigation between the State Board and the City arising from the contract, the prevailing party is entitled to reasonable costs and/or attorney fees.

In light of the Clean Water Act's requirement of a proportionate fee system, and the SRF loan program's condition of compliance with the Clean Water Act, the City should finalize and adopt the findings of an updated COSS. If the City does not proceed, it risks losing its SRF loans, which would have a severe and immediate impact on the City's budget and ability to proceed with necessary improvements.

RECOMMENDATION

The City has approximately $370 million in grants and loans, either outstanding or proposed, from the state and federal government that have provided financial assistance for the construction and improvement of the City's Metropolitan Sewerage System. Each of these grants and loans requires the City to maintain a user charge system that is compliant with the Clean Water Act. Currently, the City's user charge system does not comply with the Clean Water Act.

Each of the loan contracts permits immediately acceleration of loan repayments by the City upon breach of the contract. Thus, if the acceleration provision is invoked, the City could be required to immediately repay all of the outstanding loans. Additionally, the federal and state governments could conceivably request repayment of the grants received by the City if the City is found to have been out of compliance with grant requirements.

Finally, in any litigation concerning the loan contracts, the prevailing party is entitled to receive attorney fees and costs.

To avoid the possible acceleration of the repayment of approximately $370 million in Clean Water grant and SRF loan monies, and to ensure the continuing availability of SRF loans for the City's

MWWD program, the City should perform and implement the findings of a Cost of Service Study and continue to take steps toward making the City's wastewater user fees and charges proportionate to the cost of providing the wastewater conveyance, transmission, and treatment services.

EXHIBIT 6

574528

SALIENT POINTS
SEWER COST OF SERVICE COMPLIANCE ISSUE
November 11, 2002

ISSUE: SHALL THE COUNCIL ADOPT A SEWER RATE STRUCTURE WHICH RECOVERS THE COST OF WASTEWATER TRANSPORTATION, TREATMENT AND DISPOSAL ON A BASIS PROPORTIONATE TO USE, CONSISTENT WITH THE REQUIREMENTS OF GRANT AND LOAN CONTRACTS PREVIOUSLY AND PROSPECTIVELY ENTERED INTO BY THE CITY, SO AS TO AVOID POTENTIAL BREACH OF CONTRACT LITIGATION LEADING TO POSSIBLE REPAYMENT OF GRANTS AND ACCELERATED REPAYMENT OF LOANS ALREADY RECEIVED AND DENIAL OF FUTURE LOW INTEREST LOANS?

- **THE CITY HAS BEEN THE RECIPIENT OF SOME $370 MILLION IN STATE AND FEDERAL WASTEWATER GRANTS AND LOW INTEREST LOANS, BEGINNING WITH THE POINT LOMA ACCELERATED PROJECTS GRANTS IN THE 1970'S. SINCE THAT TIME, GRANTS AND LOANS HAVE BEEN USED TO FUND ADDITIONAL WORK AT THE POINT LOMA PLANT, PORTIONS OF THE COST OF CONSTRUCTING THE NORTH CITY WASTEWATER TREATMENT PLANT AND THE METRO BIOSOLIDS CENTER, AS WELL AS NUMEROUS WASTEWATER PIPELINE AND PUMP STATION PROJECTS THROUGHOUT THE CITY.**

- **THE CITY'S ACCEPTANCE OF GRANTS AND LOW INTEREST LOANS MATERIALLY LOWERED ITS OUT-OF-POCKET EXPENDITURES FOR MUCH NEEDED CAPITAL IMPROVEMENTS AND REDUCED UPWARD PRESSURE ON RATES.**

- **EACH GRANT AND LOAN CONTRACT ENTERED INTO REQUIRED THAT THE CITY ADOPT A WASTEWATER RATE STRUCTURE WHICH RECOVERS COSTS ON A BASIS PROPORTIONATE TO USE, CONSISTENT WITH THE REQUIREMENTS OF THE FEDERAL CLEAN WATER ACT, AS ADMINISTERED BY THE ENVIRONMENTAL PROTECTION AGENCY (EPA). FAILURE TO COMPLY WITH THIS REQUIREMENT IS GROUNDS FOR A DEMAND THAT GRANT MONIES RECEIVED BE REPAID, AND THAT PAYMENTS DUE ON LOW INTEREST LOANS BE ACCELERATED.**

- THE STATE WATER RESOURCES CONTROL BOARD (SWRCB) IS THE EPA DESIGNATED ADMINISTRATOR OF WASTEWATER GRANTS AND LOANS IN CALIFORNIA.

- TO RECEIVE SWRCB APPROVAL, THE RATE STRUCTURE MUST RECOVER THE COST OF DEALING WITH WASTEWATER FLOW, SUSPENDED SOLIDS (SS) AND ORGANICS (COD) FROM EACH SYSTEM USER ON A BASIS PROPORTIONATE TO THAT USER'S CONTRIBUTION OF THOSE CONSTITUENTS TO THE AGGREGATE AMOUNTS PROCESSED.

- THE CITY PROVIDES WASTEWATER TRANSPORTATION, TREATMENT AND DISPOSAL SERVICES TO 15 OTHER CITIES AND DISTRICTS, WHICH ARE REFERRED TO AS THE METRO PARTICIPATING AGENCIES (PA's).

- THE CITY HAS BEEN BILLING THE PA's USING AN SWRCB-APPROVED FLOW / SS / COD BILLING STRUCTURE SINCE 1997, WHEN THE CURRENT CITY / PA CONTRACTS WERE EXECUTED, BUT HAS CONTINUED TO BILL ITS MUNICIPAL USERS ON THE BASIS OF FLOW AND SS ONLY, WHICH IS A VIOLATION OF OUR GRANT / LOAN OBLIGATIONS AND THE SOURCE OF THE LITIGATION RISK WE FACE TODAY.

- THE MUNICIPAL BILLING STRUCTURE WAS NOT BROUGHT INTO COMPLIANCE WITH SWRCB REQUIREMENTS IN 1997 BECAUSE OF CONCERNS ABOUT THE ADVERSE IMPACT OF SO DOING ON CERTAIN LARGE VOLUME DISCHARGERS OF ORGANICS IN A THEN-SOFT ECONOMY. SWRCB DID NOT TAKE ISSUE WITH THIS SITUATION BECAUSE IT WAS UNDER THE MISTAKEN IMPRESSION THAT THE PA BILLING STRUCTURE IT HAD APPROVED WAS APPLICABLE TO THE CITY'S MUNICIPAL USERS AS WELL.

- IN THE FALL OF 1999, PURSUANT TO A REQUEST BY THEN-COUNCILMEMBER KEHOE, WHO WAS CONCERNED THAT RESIDENTIAL RATEPAYERS MIGHT BE SUBSIDIZING OTHER SEWER USERS, THE MANAGER WAS DIRECTED TO PREPARE, WITH THE ASSISTANCE OF A MAYOR-APPOINTED STAKEHOLDERS' GROUP, A COST OF SERVICE STUDY WHICH WOULD ADDRESS BOTH USER AND CAPACITY CHARGE EQUITY ISSUES AND SET THE STAGE FOR THE STRUCTURAL CHANGES WHICH WOULD BRING THE MUNICIPAL BILLING STRUCTURE INTO COMPLIANCE WITH SWRCB REQUIREMENTS.

- ALTHOUGH MAYORAL APPOINTMENT OF THE STAKEHOLDERS' GROUP DID NOT OCCUR UNTIL LATE JULY OF 2000, THE CONSULTING TEAM OF BLACK & VEATCH / KATZ & ASSOCIATES BEGAN PREPARATORY WORK IN LATE APRIL OF THAT YEAR. COLLABORATORY WORK BY CITY STAFF, CONSULTANTS AND STAKEHOLDERS BEGAN IN SEPTEMBER OF 2000 AND CONTINUED UNTIL MAY OF 2001, AT WHICH TIME THE STAKEHOLDERS' GROUP ISSUED A REPORT ON ITS FINDINGS. CITY STAFF AND THE CONSULTANTS CONTINUED TO WORK TO UPDATE DATA AND RESOLVE OUTSTANDING ISSUES UNTIL LATE FALL OF 2001.

- BECAUSE OF THE NEED TO INSURE THAT THE COST OF SERVICE STUDY RECOMMENDATIONS WOULD BE ACCEPTABLE TO THE SWRCB, CITY STAFF AND ITS CONSULTANTS HAD NUMEROUS EXCHANGES WITH SWRCB STAFF DURING THE COURSE OF THE PROJECT. SWRCB STAFF MADE IT CLEAR ON NUMEROUS OCCASIONS THAT THE CITY'S CURRENT RATE STRUCTURE IS NOT IN COMPLIANCE AND THAT THE CITY HAS EXHAUSTED THE SWRCB's PATIENCE.

- AS EXPECTED, THE STUDY, BASED ON FY 1999 DATA AND PREPARED UTILIZING COST ALLOCATION METHODOLOGY REQUIRED BY SWRCB, INDICATED THAT WHEN COD WAS INCLUDED IN COST CALCULATIONS, COSTS WOULD BE SHIFTED FROM RESIDENTIAL AND OTHER SYSTEM USERS DISCHARGING LOW LEVELS OF ORGANICS SUCH AS HOTELS AND ELECTRONICS MANUFACTURERS TO OTHER USERS DISCHARGING HIGHER LEVELS OF ORGANICS SUCH AS RESTAURANTS, GROCERY STORES AND MARINE PRODUCTS MANUFACTURERS, SEVERAL OF WHOM ARE QUITE VOCAL IN THEIR OPPOSITION TO SUCH SHIFTS, REGARDLESS OF THEIR EQUITY.

- IN JANUARY OF 2002 THE CITY ATTORNEY, IN CLOSED SESSION, REQUESTED DIRECTION FROM MAYOR AND COUNCIL AS TO HOW TO ADDRESS THE NOTICING AND PROPORTIONAL COST OF SERVICE REQUIREMENTS OF ARTICLE XIIID, SECTION 6. (PROPOSITION 218) IN CONNECTION WITH FUTURE SEWER RATE INCREASES. THIS QUESTION WAS RAISED IN ANTICIPATION OF AN ISSUANCE OF DEBT EXPECTED TO OCCUR LATER THAT YEAR, AND THE PROPOSITION 218 DISCLOSURE REQUIREMENTS THAT WOULD HAVE TO BE MET IN CONNECTION THEREWITH. THIS LEAD TO A DISCUSSION OF THE SWRCB's PROPORTIONATE TO USE BILLING REQUIREMENTS, THEIR APPLICABILITY TO THE PROPOSITION 218 PROPORTIONATE TO USE REQUIREMENTS, AND DIRECTION THAT THE CITY ATTORNEY REPORT

BACK ON THE CITY'S OBLIGATION TO COMPLY WITH THE BILLING REQUIREMENTS CONTAINED IN THE GRANT AND LOAN DOCUMENTS IT HAD SIGNED.

- IN OCTOBER 2002, THE CITY ATTORNEY ISSUED AN OPINION WITH RESPECT TO THE CITY'S OBLIGATION TO COMPLY WITH THE SWRCB's BILLING REQUIREMENTS. IT INDICATES THAT SIGNIFICANT EXPOSURE TO LITIGATION WOULD EXIST IF THE CITY FAILS TO COMPLY WITH FEDERAL AND STATE LOAN AND GRANT GUIDELINES, AND RECOMMENDS THAT THE CITY BRING ITS SEWER RATES AND CHARGES INTO COMPLIANCE WITH THOSE GUIDELINES.

- THE COST OF SERVICE STUDY, ESSENTIAL TO ACHIEVEING COMPLIANCE, WAS BEGUN IN LATE 2000 USING 1999 DATA AND PROJECTIONS, WAS NEVER FORMALLY COMPLETED AND ISSUED, AND IS NOW OUT OF DATE. SHOULD STAFF BE DIRECTED TO BRING RATES INTO COMPLIANCE, SOME 3-6 MONTHS WOULD BE REQUIRED FOR THE UPDATE TO BE ACCOMPLISHED AND A REVISED RATE STRUCTURE BROUGHT FORWARD FOR ADOPTION.